



# THE BULGARIAN ECONOMY

IN 2005

REPORT BY  
**THE CENTER  
FOR ECONOMIC  
DEVELOPMENT**

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*The Center for Economic Development (CED) is a Bulgarian non-governmental research institute in the area of economic policy, established in 1997. Its goal is to support the economic development of Bulgaria through encouragement of public debate on economic issues and development of economic policy options.*

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## ABBREVIATIONS USED

AASLEW.....	ACT AMENDING AND SUPPLEMENTING THE LAW ON ENVIRONMENT AND WATERS
AAVP .....	ACT ON ADMINISTRATIVE VIOLATIONS AND PUNISHMENTS
ACNR .....	ACT ON COPYRIGHT AND NEIGHBORING RIGHTS
AD/JSC.....	JOINT STOCK COMPANY
AEAF .....	AGENCY FOR ECONOMIC ANALYSES AND FORECASTS
AHI.....	ACT ON HEALTH INSURANCE
ANRA.....	ACT ON NATIONAL REVENUE AGENCY
APOS.....	ACT ON PUBLIC OFFERING OF SECURITIES
APP .....	ACT ON PUBLIC PROCUREMENT
APSME .....	AGENCY FOR PROMOTION OF SMALL AND MEDIUM-SIZED ENTERPRISES
ARARACEA.....	ACT ON RESTRICTING ADMINISTRATIVE REGULATION AND ADMINISTRATIVE CONTROL OF ECONOMIC ACTIVITY
ASPIC.....	ACT ON SPECIAL PURPOSE INVESTMENT COMPANIES
AST.....	ACT ON THE STRUCTURE OF THE TERRITORY
ATRP .....	ACT ON TECHNICAL REQUIREMENTS TO PRODUCTS
AWM.....	ACT ON WASTE MANAGEMENT
BAS .....	BULGARIAN ACADEMY OF SCIENCE
BDZ .....	BULGARIAN STATE RAILWAYS
BEIA.....	BULGARIAN EXPORT INSURANCE AGENCY
BNB .....	BULGARIAN NATIONAL BANK
BNR.....	BULGARIAN NATIONAL RADIO
BORICA.....	BANK ORGANIZATION FOR PAYMENTS INITIATED BY CARDS
BRS .....	BULGARIAN RIVER SHIPPING
BSE .....	BULGARIAN STOCK EXCHANGE
BSP .....	BULGARIAN SOCIALIST PARTY
BTC .....	BULGARIAN TELECOMMUNICATIONS COMPANY
CCP .....	CODE OF CIVIL PROCEDURE
CD .....	CENTRAL DEPOSITARY
CED .....	CENTER FOR ECONOMIC DEVELOPMENT
CEFTA.....	CENTRAL EUROPEAN FREE TRADE ASSOCIATION
CoM.....	COUNCIL OF MINISTERS
CPC .....	COMPETITION PROTECTION COMMISSION
CPC .....	CRIMINAL PROCEDURE CODE
DCoM .....	DECREE OF THE COUNCIL OF MINISTERS
DSB .....	DEMOCRATS FOR STRONG BULGARIA
EA.....	EMPLOYMENT AGENCY
EAD .....	SOLE-PROPRIETOR JOINT STOCK COMPANY
EC.....	EUROPEAN COMMISSION
EPMC .....	ENVIRONMENT PROTECTION MANAGEMENT COMPANY
EU.....	EUROPEAN UNION
FA .....	FOODS ACT
FSC .....	FINANCIAL SUPERVISION COMMISSION
FTA.....	FIXED TANGIBLE ASSETS
GDP .....	GROSS DOMESTIC PRODUCT
GMO .....	GENETICALLY MODIFIED ORGANISMS
GVA .....	GROSS VALUE ADDED
HACCP .....	HAZARD ANALYSIS AND CONTROL OF CRITICAL POINTS
IBRD .....	INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
ICT.....	INFORMATION AND COMMUNICATIONS TECHNOLOGY
IMF .....	INTERNATIONAL MONETARY FUND
LC.....	LABOR CODE
LFS.....	LABOR FORCE SURVEY
MAF .....	MINISTRY OF AGRICULTURE AND FORESTRY
MEE.....	MINISTRY OF ECONOMY AND ENERGY
MEW.....	MINISTRY OF ENVIRONMENT AND WATERS
MF .....	MINISTRY OF FINANCE
MH.....	MINISTRY OF HEALTH
MI.....	MINISTRY OF INTERIOR

## ABBREVIATIONS USED

MLSP .....	MINISTRY OF LABOR AND SOCIAL POLICY
MRDPW .....	MINISTRY OF REGIONAL DEVELOPMENT AND PUBLIC WORKS
MRF .....	MOVEMENT FOR RIGHTS AND FREEDOM
MT .....	MINISTRY OF TRANSPORT
MV .....	MOTOR VEHICLE
NA .....	NATIONAL ASSEMBLY
NAMRB .....	NATIONAL ASSOCIATION OF MUNICIPALITIES IN THE REPUBLIC OF BULGARIA
NCOPSH .....	NON-COMMERCIAL ORGANIZATIONS PROVIDING SERVICES TO HOUSEHOLDS
NDP .....	NATIONAL DEVELOPMENT PLAN
NEC .....	NATIONAL ELECTRICITY COMPANY
NFI .....	NON-FINANCIAL INSTITUTION
NHIF .....	NATIONAL HEALTH INSURANCE FUND
NMB .....	NAVIGATION MARITIME BULGARE
NMSS .....	NATIONAL MOVEMENT SIMEON THE SECOND
NPP .....	NUCLEAR POWER PLANT
NRA .....	NATIONAL REVENUES AGENCY
NSI .....	NATIONAL STATISTICAL INSTITUTE
NSSI .....	NATIONAL SOCIAL SECURITY INSTITUTE
OECD .....	ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
OJ .....	OFFICIAL JOURNAL
OOD/LTD .....	LIMITED LIABILITY COMPANY
OPF .....	OCCUPATIONAL PENSION FUND
PA .....	PRIVATIZATION AGENCY
PIC .....	PENSION INSURANCE COMPANY
PIFCA .....	PUBLIC INTERNAL FINANCIAL CONTROL AGENCY
PIN .....	PERSONAL IDENTIFICATION NUMBER
PPA .....	PUBLIC PROCUREMENT AGENCY
PPP .....	PUBLIC-PRIVATE PARTNERSHIP
PPR .....	PUBLIC PROCUREMENT REGISTER
RHEI .....	REGIONAL HYGIENE AND EPIDEMIOLOGY INSPECTORATE
RPHPCI .....	REGIONAL PUBLIC HEALTH PROTECTION AND CONTROL INSPECTORATE
RVS .....	REGIONAL VETERINARY SERVICE
SAC .....	SUPREME ADMINISTRATIVE COURT
SAMTS .....	STATE AGENCY FOR METROLOGY AND TECHNICAL SURVEILLANCE
SEWRC .....	STATE ENERGY AND WATER REGULATORY COMMISSION
SHEI .....	STATE HIGHER EDUCATION INSTITUTION
SIM .....	SPECIAL INTELLIGENCE MEANS
SIN .....	SINGLE IDENTIFICATION NUMBER
SMEs .....	SMALL AND MEDIUM-SIZED ENTERPRISES
SMPI .....	SUPPLEMENTARY MANDATORY PENSION INSURANCE
SPO .....	SUPREME PROCURATOR'S OFFICE
SSS .....	STATE SOCIAL SECURITY
SVPI .....	SUPPLEMENTARY VOLUNTARY PENSION INSURANCE
TFP .....	TRANSITIONAL AND FINAL PROVISIONS
TIPC .....	TAX INSURANCE PROCEDURE CODE
TPP .....	THERMAL POWER PLANT
UN .....	UNITED NATIONS ORGANIZATION
UPF .....	UNIVERSAL PENSION FUND
USAID .....	UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
VAT .....	VALUE ADDED TAX
VPF .....	VOLUNTARY PENSION FUND
WTO .....	WORLD TRADE ORGANIZATION

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## SUMMARY

*The Bulgarian economy experienced a slow-down in growth during the second half of 2005. The business climate deteriorated and, around the end of 2005, stabilized at levels lower than the 2003 and 2004 average. The highest score of the ESTAT Business Climate Index was considerably lower than the highest 2004 levels.*

*The output growth rate registered a decline and exports were stagnated while imports rate sky-rocketed mostly due to the sharp increase in private consumption and investments. A negative trend is observed in the dynamics of industry, services and agriculture; the growth in industry is ahead of that for services while the agricultural sector continues downward.*

*Labor productivity (measured as value-added per person employed) is falling behind the growth in employment. This translates into a regression to the negative trend of 2004 following a break in this trend registered in the first half of 2005.*

*At the same time, investments into the economy have grown considerably as a result of the lending boom, the requirements for companies to cover certain standards, and the recovery effort in the aftermath of recent floods.*

*The major macroeconomic problem – the current account deficit – is deepening, thus raising concerns about the overall financial stability. The share of energy resources in imports increased sharply; the share of investment goods is also up which means that the trade deficit is caused not just by the rise in consumption but also by the increased investment activities and should therefore not be judged as an entirely negative development.*

*Foreign investment for 2005 is expected to reach BGN 2.2 – 2.3 b; it is worth noting that no major privatization deal is involved in these estimates. If these investments are indeed harnessed into productive rather than speculative activities, they will guarantee the stability of the balance of payments and the Currency Board.*

*The “taming” of the lending expansion was a temporary phenomenon and a new surge rekindled concerns over the long-term stability of the banking system. The stock market closed 2005 on a downward trend while insurance registered a growth as a result of some liberalization measures.*

*In the public finance field, the trend of increased reallocation through the budget continued; the budget surplus is also continuously growing while the tax and social security burden in 2006 will be at least as heavy as it was in 2005.*

*As regards individual business sectors, the positive developments in tourism and telecommunications have been*

*most dynamic. Transport and agriculture, especially given the flood-inflicted damage, are lagging behind.*

**Economic growth** in Q3 slowed down more than expected and reached 4.6 per cent on a year-over-year basis. Given the 5.6 per cent growth during the nine months of 2005 it seems highly improbable that growth for the entire year would top the 2004 figures (5.6 per cent) because Q4 growth can hardly exceed the 5.8 per cent mark.

The growth characteristics during the quarter under review include a considerably slow-down in production, stagnated exports of goods and services, increased stocks and higher consumption and investment manifested in higher import rates. On the *supply* side, the GDP growth of 4.6 per cent (over Q3 of 2004) is formed from the (slower) growth in value-added of 3.4 per cent and (accelerated) growth in adjustments by 13.9 per cent. The growth in adjustments results in higher growth of GDP at market prices over the growth of value-added at basic prices and corresponds to the increased growth in the imports of goods and services.

Negative developments are observed in all three economic sectors (industry, services and agriculture). Although the value-added for the industrial sector is growing at a higher pace as compared to the third quarter of 2004, the trend of acceleration registered in the first half of the year turned into deceleration. Nevertheless the growth in industry is again higher than growth in services; the latter continues to slow down. In 2005, agriculture suffered the most negative developments and continued on a path of progressive stagnation.

Another negative sign for growth potential is the fact that both the general indicator and the compound business climate indicators in industry, construction, retail trade and services measured over the last three months of 2005 through the NSI business surveys fall below the levels for the respective months of 2004.

On the *demand* side, a negative development has been the continued stagnation in the exports of goods and services; exports grew by just 0.9 per cent on year-over-year basis and its contribution to GDP growth was only 0.6 percentage points. At the same time the contribution of domestic demand sharply increased, reaching 15.9 percentage points, which is mostly accounted for by the increased consumption rate for households (a contribution of 7.0 percentage points) and investment (contribution of 4.7 percentage points). A new development in Q3 was the increase in stocks whose contribution to GDP growth rose to 4.1 percentage points over 1.7 percentage points for the preceding quarter. The accelerated imports on the background of unchanged exports deteriorated the overall negative contribution of foreign trade in goods and services to minus 11.3 percentage points.



Final *consumption* accelerated due to the increase in private consumption to 9.7 per cent while collective consumption registered a slowed-down growth rate at a year-over-year basis of 5.2 per cent.

The sharp increase in the growth of *investment* to 25.4 per cent in Q3 is attributable to quality and safety standards that enterprises had to cover by end-2005, the lending expansion of commercial banks and the efforts to recover flood-inflicted businesses. Still under the influence of these factors, high growth rates in investment can be expected for the fourth quarter.

Starting from the second quarter of the year, *stocks* in the economy have grown considerably which is, to a certain extent, attributable to unfinished construction works. During the third quarter however (if the export dynamics does not change) we can safely predict an increased share of finished products intended for export but not actually exported.

Following a span during the first half of 2005 during which *the export of goods and services* gained pace and its growth rate exceeded the rates for the respective quarters of 2004, Quarter 3 saw only a little less than 1 per cent increase in the exports of goods and services over the exports in the third quarter of 2004. This situation also reflects the consequences of natural disasters that plagued the country in the summer. *The imports of goods and services* continued to grow at an accelerated pace during Q3 in response to the need to strike a balance between the delay in production and the sharp increase in domestic demand.

The increased share of capital formation in GDP (reaching 26.6 per cent for the three quarters) persists on the background of increased external savings and lower national savings. Financing investments at the expense of national savings has shrunk to 55 per cent for the first nine months of 2005 over 77 per cent for the same period of 2004.

The **current account** deficit on the balance of payments for the ten months <sup>1</sup> since the beginning of 2005 was twice as high as the same period of 2004. Apart from the traditionally largest and increasing negative contribution of the trade balance deficit, the current account deficit has also deteriorated due to the lower positive balances for services and current transfers. The growth rate of exports has been decreasing in nominal terms while the growth rate of exports has been going up. In spite of the increase in the positive balance for tourism, the deteriorated negative balance for transport and the reverse trend (from positive to negative) for the balance for "Other Services" have resulted in a lower positive balance for services and the overall negative contribution of this group to the current account movements. The only positive contribution to the current account movement is the smaller negative balance on incomes.

In 2005 the proceeds from travels grew at a considerably lower pace as compared to previous years and there is a downward trend in the net flow (in absolute terms) of current transfers. For the ten months of 2005 (over the same period of 2004) the net inflow of current transfers in absolute terms is 1.7 per cent less, and the proceeds from cash transfers - which represent 70 per cent of the overall volume of transfer payments have gone down 7.4 per cent. Deficit coverage on the current account with foreign direct investments will probably stay below the 100 per cent mark during the entire 2005. This coverage is even expected to fall below the 2001 levels; 2001 is the only year during the 1999-2004 period in which the deficit was covered below 100 per cent by foreign direct investments.

The ratio of **foreign trade** to gross domestic product - which illustrates the degree of integration of Bulgaria's economy into global economy - has grown from 103 per cent in 2004 to 119.5 per cent in 2005. The total trade volume for the ten months of the year has grown by about 23.7 per cent over the same period of 2004 with the increase for the entire year being about 22 per cent. The rate of growth in imports (27.6 per cent for the first ten months) has been ahead of export rates (18 per cent) all through the year. Thus the foreign trade deficit (exports FOB - imports CIF), which for 2004 reached 3.6 b Euro, or 45 per cent of exports, for the ten months of 2005 already climbed to EUR 4.1 b (53 per cent of exports) with a tendency to reach EUR 5.1 b (54 per cent of exports) before the year is out.

The product structure of exports registers a trend of gradual increase in the share of goods with higher added value. As regards imports, along with the sharp increase in the value and share of energy resources, a major increase is also measured for investment goods, almost half of which constitute machinery, plant, and equipment. The restructuring of most Bulgarian enterprises has been finalized; the construction of new plants and the expansion of existing ones are ongoing. This will enable the stable growth of exports by over 20 per cent per year. At the same time, no decrease in the growth rate of imports is to be expected.

The stable economic environment, the relatively good rate of return and moderate risk rates for investment in the country continue to attract **foreign investors**. Practically all international observers share the opinion that the considerable volume of foreign capital that has infiltrated the country and continues to grow is a sign of the high marks given to the potential of Bulgaria's economy to grow and provide good opportunities for business development. Annual investments are expected to reach EUR 2.2-2.3 b for 2005 (as much as in 2004) notably, without a major privatization deal.

In 2005, the monthly fluctuation of **consumer prices** was mostly determined by the dynamics of the market prices of

<sup>1</sup> Source: BNB, balance of payments.

consumer goods and services, which, in turn, depends mostly on the changes of food prices.

The sharp slowing down in the growth of value-added in the economy during the third quarter broke the trend since the beginning of 2005 of leading growth in **productivity** as compared to employment.

Throughout 2005 the number of **unemployed people** continued to drop, with the changes based on labor force surveys (LFS) and the Employment Agency data being very close. As a result, the index calculated using the LFS is now a single-digit number - 9.2 per cent for the third quarter of 2005, and under the Employment Agency methodology it was 10.36 per cent in November and will probably also shrink to a single digit soon.

In October 2005, the **Estat index** of business climate in Bulgaria reached its highest value for the year – 3.73. This figure is however considerably lower than the values of approximately 5 points registered in the middle of 2004. The fact that the maximum value was registered in autumn instead of summer is mostly attributable to managers' uncertainty associated with the general elections and the difficulties surrounding the new government in July and August. The index value registered in October is the result of for the year's highest investment attitudes (25.9), in combination with the satisfactory, almost unchanged condition of companies and the traditional skepticism vis-à-vis state policy in the economic sphere. In the first months of the Stanishev Cabinet, feedback on the condition of the business environment is much the same as that received at the end of the term in office of the government headed by Saxe-Coburg-Gotha.

The deteriorated overall economic outlook in country (following the 11- year long-term maximum reached in June) which was registered with the month-by-month decline of **NSI general business climate indicator** since July (by 2.3-3.5 points) also continued in October when the indicator dropped another 3.6 points from its September level. In November and December we can assume that there has been a certain stabilization in the business climate levels because the indicator in November is only 0.5 points below the October level, and in December it remains at November levels. Thus at the end of 2005 the business climate indicator fell below the average values for 2003. An unfavorable trend as regards the growth potential is the fact that both the general and the compound business climate indicators in the monitored sectors are, generally speaking, below the levels for the respective months of 2004.

In 2005, measures were taken in the country to support **entrepreneurship** and improve the **business environment**. Some of the more important ones include: the easing up the start-up of business with the adoption of the BULSTAT Act; the implementation of projects in support of SMEs; the faster and improved public procurement procedures, the preparation for

the Single European market etc. Another major development was the launching of the National Innovation Fund. New SME credit lines were established; European standards were introduced in several sectors; the Bulgarian Export Insurance Agency stepped up its activity. The government announced its intention to boost public-private partnerships in a number of areas. Meanwhile problems persisted or deepened in some areas of major significance.

- The Government Program presented by the new cabinet does not set clearly enough the priorities in respect of structural reform, including the privatization and concessions of monopolies and infrastructure. It is possible that the limited resource of state-owned companies and the legal disputes over "major" privatization and concession deals to further slow down the structural reform in the country.
- Businesses are still not satisfied with the outcomes in terms of easing up of regulatory regimes and the implementation of ARARACEA.
- There still exists distrust in the objectivity and transparency of public procurement which should translate into further upgrading of the normative base and the capacity for its implementation.
- The major barriers that continue to impact negatively businesses and entrepreneurship are to a large degree associated with the state of the judiciary and the presence of corruption practices. The long-awaited reform of the judiciary branch registered no progress over the past year. Irrespective of the steps made in this direction, radical changes are yet to happen.

The development in **public finance** as at the end of 2005 is characterized by the preserved major trends underlying in structure of Budget 2006. Among these are the increase in the actual quota of reallocation through the budget, the overblown chronic budget surpluses and the strengthened role of the state in Bulgarian economy. The changes in tax and social insurance legislation will not result in smaller tax and social insurance burdens but will only lead to a shift in this burden from direct to indirect tax, which is in itself a positive development but does not represent an incentive for increased economic growth.

Positive developments on the **labor market** have continued, fuelled by economic growth and active measures and employment policies. The lasting and deepening structural discrepancies related to the level of education and qualifications of the workforce still present a serious problem. Companies are increasingly faced with difficulties to recruit properly qualified staff due to the deteriorated quality of secondary and university education. The Government's program in this area is appropriately tuned. The most important priority should be improving the employability of the workforce through training, qualification and basic literacy for the unemployed. The implementation of alternative forms of working time organization and of employment in general should

be particularly encouraged; the flexibility in the labor market should be improved.

In 2005 **personal incomes** registered a moderate growth in real terms which is comparable to previous years. The Government's estimates predict a 10 per cent increase in incomes next year but there are a number of signs showing that such growth would prove hardly achievable in light of the accelerating inflation. The Government's policy on incomes has set some ambitious goals and proposed annual raises of the minimum wage, expanding the scope of collective bargaining by sectors and companies, and the application of flexible remuneration schemes through changes in the labor and social insurance legislation. These programmatic intentions sound well-grounded and show willingness for change and development but it still remains to be seen whether they can be legally and institutionally enacted.

Cutting the size of **pension insurance** contributions was the most important step in the area of social policy. It was justified by the success of the pension reform of 2000 and the improved collection rate for social insurance payments. At the same time there has been a constant trend in the course of the past year of increase in the assets of pension funds and growing numbers of insured individuals. The potential positive effect of the reduced social insurance burden in 2006 can only be realized in an environment of long-term financial stability of the state social insurance system. For this purpose, the government should take the following steps:

- set up an investment Silver Fund to finance the deficit;
- establish mechanisms for a more flexible participation in the pension system and boost the employment rate for active elderly people;
- improve the collection rate of contributions to the National Revenue Agency and establish an integrated information system;
- establish economic incentives and a tolerant tax environment for the development of the second and third pillar of pension insurance and ensure the liberalization of the investment regime.

**The healthcare reform** posed one of the most important social problems in the course of the past year and these should find a solution in the shortest possible deadlines. These problems include: the collapse in the financial scheme for healthcare establishments where indebtedness reached over BGN 200 m at the end of the year; the large share of people whose health insurance status has been suspended (over 1 million people, or 13.6 per cent of the population); problems related to the supply of medicines and problems related to unregulated payments patients are forced to make for medical services. The Government's efforts to ensure high-quality health services and guarantee the social rights of health-insured people should focus on:

- restructuring and privatization of hospitals to achieve a balance of public expenses in health insurance;
- introducing a transparent and controllable mechanism to finance health services through national health accounts;
- establishing an integrated information system and introducing personal electronic cards to ensure efficient control on patients' health insurance status;
- ensuring the adequate legal regulation of contracts for the supply of free and partially paid medicines and price monitoring;
- regulating the conditions and procedure for supplementary payments by patients for services received.

The main priority for public administration in the area of **environmental policy** in 2005 was to achieve compliance of national legislation with the currently valid EU directives. The good progress in this aspect is beyond any doubt. The participation of Bulgarian projects in international emission trade schemes under the Kyoto Protocol has been active and successful, while results in the field of waste management and recycling, industrial pollution proved below expectations, and the management of natural resources at the regional and local level was ineffective.

**The banking system** continues to dominate the financial sector and financial mediation in this country. The latest statistics show that the lending boom was only temporarily restrained. Following a short decline, the growth in lending returned to its high levels and thus rekindled apprehensions for the medium-term and long-term stability of the banking system. In November BNB announced a new set of measures to curb the credit expansion; these can be positively appreciated. It is necessary to abandon administrative measures and turn entirely to market-oriented measures. The decision to monitor and regulate non-bank lending, and particularly leasing companies, is justified.

**The capital market** closed the year on a note of declining indexes in spite of the good performance of key traded companies. The turnover increased on the background of a smaller number deals, which is typical for underdeveloped markets like ours which is highly dependent on individual package transfers. Compensatory instruments registered a one-third decline in prices. The discussions over the institutional future of the Bulgarian Stock Exchange and the Central Depository in increasingly internationalized capital markets gained new prominence.

**The insurance sector** in Bulgaria registered a 35 per cent growth during the nine months of 2005. The structure of insurance portfolios is dynamically changing, following the trends of the European market. Important legislative changes were introduced in December more closely aligning Bulgarian legislation with the EU *acquis*. These changes place the sector in a free market environment but also increase the requirements the sector has to meet. There has been some concern about

the two cases of insurance companies which had their licenses withdrawn by the Financial Supervision Commission (FSC). Against this background, the regulatory measures accompanying this liberalization (by FSC and other regulatory bodies), especially in the area of mandatory insurance, are of particular importance.

The end of 2005 revealed the major importance of Russian **energy** resources to the European and, more specifically, to the Bulgarian economy, and stressed the need for diversification of energy sources.

Currently, the steps towards liberalization on the electricity market do not rule out an administrative approach because the State Energy and Water Regulatory Commission preserves its role as regulator in charge of setting power generation quotas and prices. In the international market of electric power, Bulgaria became the co-founder of an Energy Community between the EU and South Eastern Europe countries. The common energy market thus established is expected to attract substantial investments into the energy infrastructure. The privatization procedure for the cogeneration plants in Varna and Rousse are again in a deadlock after the winning company in both deals withdrew from the deal in Varna. At the end of 2005, the long-deferred rehabilitation and modernization of Maritsa-Iztok 1 was launched.

In the **transport sector**, some changes were introduced in the management of state-owned companies. The Ministry of Transport (MT) announced its priorities but failed to achieve a breakthrough in any of the major concession deals. In 2005 the total passenger flow for the international airports in Sofia, Varna, and Bourgas reached five million people which demonstrated the need to improve the infrastructure of passenger terminals and increase their capacity. During the last quarter of 2005, yet another extended deadline was agreed for the new terminal of Airport Sofia, and the final decision on concession for the two seaside airports was postponed yet again. At the end of 2005, MT disbursed BGN 12 m from its budget to provide support to BDZ EAD. The financial stabilization of the company was also listed in the Government's Program. In order to achieve lasting effect, the company should be restructured – an issue on which no clear plans have yet been outlined. There are still a number of aspects to be clarified about the Trakia Motorway. The Government announced that it is planning to commission 60 km of motorway in 2006; this however does not satisfy the country's needs for new road infrastructure.

In 2005 **tourism** continued on its upward trend even though it failed to achieve the growth rates that are both desirable and achievable. A major reason behind this is the poor condition of the infrastructure which continues to be a barrier to the development of tourism in many of the country's regions. Experts claim that Bulgaria has the potential to welcome about 10 million foreign tourists each year. To date, however, this

figure is more in the range of 3-4 million people. Revenues from tourism could reach EUR 7-8 billion on condition that the transport and other infrastructure is considerably upgraded and the sector successfully deals with existing deficiencies.

The process of rapid renovation and expansion of tourist facilities continued throughout 2005. In parallel with some undisputed success stories, the unresolved issues also persisted: chaotic and poorly planned construction that is damaging the environment. The difficulties in recruiting properly qualified staff were even more clearly outlined. The snowballing growth in specialized infrastructure is not accompanied by adequate staff training and qualification. There is still a lack of sufficiently targeted and properly addressed advertising effort to present Bulgaria as a tourist destination. The accumulation of these and some other problems condemns the country to the status of a location mostly visited by low-income tourists. Other specialized forms of tourism continue to be underdeveloped.

At the beginning of the winter season forecasts are good: they point at an increase in the number of tourists by 10-20 per cent. Winter resorts continue to be most attractive to Russian, British, Greek and Macedonian tourists.

The year was not a good one for the **agriculture sector**. The downpours in summer damaged (and, in many places, even destroyed) part of the crops. This strengthened the trend for the shrinking share of this sector in national economy. Efforts were mostly focused on the preparation for the country's accession to the EU. On the one hand, this means establishing the necessary organization for application of the *acquis* and tackling the delay (as registered in the Monitoring Report) in the setting up of a Paying and Intervention Agency and an Integrated Administration and Control System through which EU funds will be disbursed after 2007. On the other hand, a major challenge continues to be the change in the structure of agriculture, which is still dominated by small holdings that must merged and diversify their activity. The European Commission's recommendations also addressed the need to improve the coordination of efforts on trade mechanisms and common market organization for various agricultural products, strengthening veterinary control on the domestic market and building the necessary veterinary border inspection posts.

Clustering, a relatively new approach in the development of **regions** in Bulgaria, continued in 2005. This is an efficient tool for regional development, economic growth and achieving a balance and cohesion between regions. Over the past years a number of good practices were implemented in local government. Serious attention was given to public-private partnerships in developing strategic and planning documents for municipalities and in implementing specific projects. At the end of 2005, a consensus was reached on the European Union budget framework for 2007-2013. Over this period, Bulgaria will receive EUR 11.1 b, which is EUR 144 m more than the



initially proposed amount. The resources Bulgaria will receive from EU pre-accession and structural funds are the largest when calculated on a per-capita basis as compared to all new Member-States. The money will be channeled for rural development and support to farmers, the construction of roads, improving the competitiveness of the economy and enterprises etc. The successful absorption of European funds requires the establishment of institutional and administrative capacity. Some of the most important strategic and planning documents in regional policy were adopted in 2005. These are: The 2007-2013 National Development Plan with its pertaining Operational Programs, and the National Regional Development Strategy. A major development was the elaboration of regional plans setting the goals and priorities in the development of planning regions in the country.

In the area of **high technologies** in late 2005, positive developments were mostly limited to the telecommunications market. Changes include the purchase by a foreign investor of one of Bulgaria's largest alternative operators – Orbitel, and also the (un)expected turn in the development of the point-to-multipoint licenses. At long last, the third GSM operator is now operational; it is owned by BTC - Vivatel. At the end of the year a new edition of the 2005 eBulgaria analysis was published; it measures the country's progress in respect of the use and spread of ICT in economic, political and public life.

2005 was marked by numerous changes in **legislation** associated with Bulgaria's major foreign policy goal: the country's EU accession in 2007. By that date, the process of harmonization of national law with the *acquis* must be completed. At the end of its mandate the 39th National Assembly adopted amendments to Constitution of RB; one of the major new aspects being that EU citizens would be legally allowed to acquire land ownership rights in Bulgaria as of the date of accession. The 39th National Assembly approved some major changes in executive court proceedings by introducing the institution of private bailiffs; it adopted a Code on International Private Law, several major pieces of legislation related to registrar proceedings, the public offering of securities and public procurement. In the first months of its mandate, the 40th National Assembly continued its efforts on the harmonization of national law. One of the major achievements in legislation was the adoption of the new Penal Procedure Code which defines in a new way the prosecutor's and investigative structures' role in the pre-court proceedings on criminal cases. The Parliament also approved amendments to the Commercial Code, the regulation of the public offering of securities and public procurement.

## Gross Domestic Product

**Economic growth.** Economic growth in Q3 slowed down more than expected and according to preliminary estimates by the NSI, it went down to 4.6 per cent on an annualized basis. Although the country's economic outlook looked relatively favorable, notwithstanding the signs of a slow-down following the high and upward-moving growth we observed during the first half of the year, the summer floods obviously had some decisive impact which is hard to determine in advance. Thus, given the 5.6 per cent growth over the nine months of 2005, it seems highly improbable that growth for the entire year would top the 2004 figures (5.6 per cent) because, in our opinion, Q4 growth would hardly exceed the 5.8 per cent mark<sup>2,3</sup>.

The overall growth characteristics in Q3 of 2005 include a considerably slow-down in production, stagnated exports of goods and services, increased stocks, the sharp increase in household consumption and investment activity, manifested in higher import rates.

**Supply.** GDP growth by 4.6 per cent over Q3 of 2004 is formed from the growth in value added total for the economy by 3.4 per cent and growth in adjustments<sup>4</sup> by 13.9 per cent. As compared to the growth rates in Q3 of last year, and the previous quarter, the growth rate for value added is about twice as low, and the growth rate for adjustments – about twice as high.

The high growth rate for adjustments, which contributes to the higher growth of GDP at market prices over the growth of value added at basic prices, is quite in line with the new growth in the imports of goods and services (to 19 per cent, which is higher both as compared to the 15.5 per cent growth for the preceding quarter, and as compared to the 11.9 per cent growth for Q3'2004).

*Growth by Economic Sector.* Negative developments are observed in all three economic sectors. Although the value added for the industrial sector is growing at a higher pace as compared to growth in the third quarter of last year, the trend of acceleration registered in the first half of the year turned into deceleration in Q3. Nevertheless the growth in industry is again ahead of growth in services. Growth in the services sector continues to slow down and is now lower both as compared to the third quarter of last year, and as compared to the preceding

quarter. Agriculture suffered the worst developments this year and is continuing to contract.

The growth in value added in services has gone down to 4.8 per cent (at 6.4 per cent for the preceding quarter and 6.5 per cent for Q3'2004). The contribution of services to the Gross Domestic Product growth is still highest (2.3 percentage points).

The industrial sector (industry and construction) continued to be the fastest developing sector this year; its value-added increased by 6.5 per cent (at 9.3 per cent growth for the preceding quarter and 5.3 per cent for Q3'2004).

Unlike 2004, the movement in industrial sales in 2005 was in the negative direction. What is characteristic of the sources of growth in industry in 2005 is that export industrial sales are growing at considerably lower, and diminishing in the course of the year on an annualized basis, as compared to the 2004 growth rates. On the other hand, the growth rate for domestic sales went up during the first half of 2005 and exceeded the 2004 rates, but this trend was reversed in Q3, negatively enhanced by the unfavorable weather conditions. Thus for example in Q3 of 2005 the growth in industrial sales for exports went down to 10.8 per cent while for Q3 of 2004 it was 49.1 per cent; the growth in domestic sales was 6.5 and 8.1 per cent, respectively. As a result the contribution of exports and domestic sales to the growth in industrial sales is 5.4 and 3.3 percentage points respectively in Q3 of 2004 the contribution was 18.8 and 5.0 percentage points, respectively<sup>5</sup>.

Since the beginning of the year, value added in the agricultural sector has been continually going down on an annualized basis. Following a 1.7 per cent drop in the first quarter and a further 5.2 per cent decline during the second quarter, in Q3 value-added in agriculture was 6.6 per cent less as compared to the respective period of 2004, when it went up by 13.9 per cent on an annualized basis. According to the first estimates published by the NSI<sup>6</sup> for the entire 2005, the value-added generated in agriculture, which is the predominant branch in the agrarian sector, is 18 less in real terms than in 2004.

An negative sign as regards growth potential is the fact that both the general and the compound business climate indicators in the sectors monitored by the NSI surveys<sup>7</sup> (industry, construction, retail trade and services) are, generally speaking, below the levels for the respective months of 2004.

<sup>2</sup> Source: NSI, National accounts, data published as at 19 December 2005, and own estimates.

<sup>3</sup> AEAf (The Bulgarian Economy: Analysis and Outlook, October, 2005) forecast 5.0 per cent growth for Q4, and 5.9 per cent growth for the year. BNB expectations (Economic Review, November 2005) are for 6 per cent growth on an annualised basis in Q4.

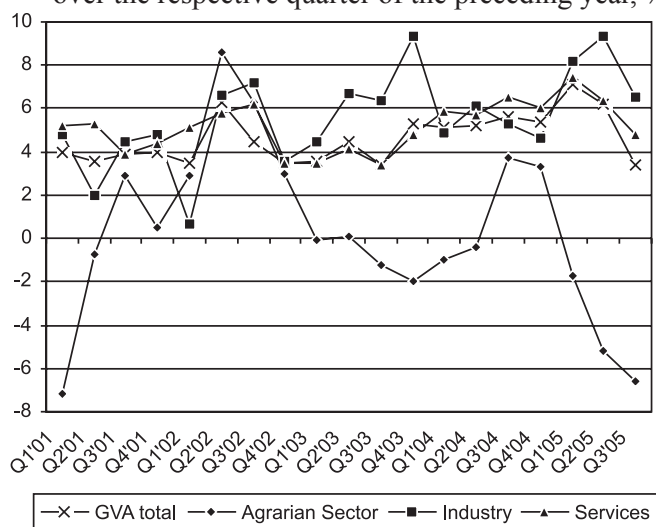
<sup>4</sup> When calculating GDP using the production method, the following methodological link is used: Gross Domestic Product (market prices) = Gross Value Added (basic prices) + Adjustments, Adjustments being = Net Tax (excise duty, duty tax, VAT, less subsidies) divided by products less Financial Intermediation Services Indirectly Measured (FISIM). The Financial Intermediation Services Indirectly Measured component is included under "Adjustments" with a minus sign as it represents the financial intermediaries' products which is assumed to be entirely used for intermediary consumption; however as it is not possible to spread it statistically to individual producers, the adjustment is calculated at national level.

<sup>5</sup> Source: BNB, Economic Review, November 2005, NSI figures.

<sup>6</sup> Source: NSI, Agrarian Statistics, Economic Accounts for Agriculture, data published as at 20 December 2005.

<sup>7</sup> See this Report Business Climate in the Fourth Quarter of 2005, NSI figures.

Figure 1. Added Value by economic sectors, real growth over the respective quarter of the preceding year, %



Source: NSI

**Growth in the private sector.** The value added in the private sector is growing at a lower pace (5.6 per cent) as compared to the preceding quarter growth (9.1 per cent) and as compared to Q3 of 2004 (7.2 per cent). At the same time, data from labor force surveys reveals that the number of people employed in the private sector has gone up by 5.3 per cent on an annualized basis. Thus in Q3 productivity in the private sector (measured as value-added per one person employed) is almost not registering any growth (just 0.3 per cent) compared to the growth in the number of people employed. Following the tendency of leading growth in productivity over growth in employment registered in the first half of the year, this turnaround is mostly attributable to force majeure factors and we can expect it to have been just a temporary episode.

**Demand.** What causes the most concerns about the slowing overall economic growth registered in Q3 of 2005 is the stagnation in the export of goods and services which only grew by 0.9 per cent on an annualized basis (following a 12 per cent growth for the preceding quarter and a 14.1 per cent growth for Q3'2004). Thus its contribution to GDP growth fell to 0.6 percentage points (against 7.3 percentage points in the preceding quarter and 8.3 percentage points in Q3'2004). At the same time, the contribution of domestic demand sky-rocketed, reaching 15.9 percentage points, which is mostly attributable to the increase in consumption by households (7.0 percentage points contribution) and investment (4.7 percentage points contribution) – in our opinion, additionally boosted by natural disasters. A feature of domestic demand during this quarter which should be given special attention is the growth in stocks whose contribution to GDP grew to 4.1 percentage points, following the 1.7 percentage points result for the preceding quarter. The accelerated imports on the background of unchanged exports deteriorated the overall negative contribution of foreign trade in goods and services to minus 11.3 percentage points (following

the minus 4.1 percentage points for Q2'2005 and plus 1.5 percentage points for Q3'2004).

**Consumption.** Final consumption accelerated due to the faster increase in private consumption while collective consumption registered a slow-down on a year-to-year basis. Final consumption went up 9.2 per cent (after a 5.9 per cent score for the preceding quarter and 3.6 per cent for Q3'2004), with private consumption up 9.7 per cent (following a 5.7 per cent score for the preceding quarter and 3.8 per cent in Q3'2004), and collective consumption went up 5.2 per cent (at 7.4 per cent for the preceding quarter and 2.0 per cent in Q3'2004). On the general background of expectations that the delay in the growth of final consumption would continue (such delay was registered in the second quarter of the year) the sharp increase in consumption by households can be logically interpreted as an outcome of the unforeseen economic loss suffered and the ensuing demand for consumer goods and services. In support of the stagnating trend for growth in consumption are also the consumer attitudes registered by the October consumer monitoring survey<sup>8</sup>, summarized under the indicator “consumer confidence”, which went down 7.1 points, having already declined 2.8 points as early as July in spite of the peaking economic growth during the second quarter. We would also like to note the indications of the deteriorated financial situation of households registered by the same survey. In October, the indicator of households' financial condition went down 3.8 points as compared to 12 months earlier; moreover, expectations for the financial condition of households in the next 12 months are also going down (by 7.6 points).

**Investments<sup>9</sup>.** The sharp increase in investment growth to 25.4 per cent in Q3 (following a 16.8 per cent growth in Q2 and 9.2 per cent in the first quarter, and 12.6 per cent in Q3'2004) can be interpreted as a forced increase in investment expenditures, on the one hand, because of the time-limited (by end 2005) requirements for enterprises to cover quality and safety standards, and, on the other, to recover the damage caused by floods on companies' and households' fixed tangible assets, as well as the damage caused to infrastructure facilities. Still under the influence of these factors, high growth rates in investment can be expected also in the fourth quarter of this year.

**Change in stocks.** Starting from the second quarter of the year, stocks in the economy have grown considerably. While in the first quarter, the increase in stocks represented 2.2 per cent of GDP, in Q2 this share doubled, reaching 4.6 per cent, and in Q3 hit the 5.7 per cent mark. This dynamics in stocks is to a certain extent attributable to the increase in unfinished construction (taking into account the high growth rate in construction); in Q3 however (given the stagnation in exports) we could assume that

<sup>8</sup> Source: NSI, Consumer Monitoring Survey, October, 2005

<sup>9</sup> For the sake of shortness, we are using the term *Investments* instead of *Gross Fixed Capital Formation*, which consists of acquisitions of tangible and intangible long-term non-financial assets, including adjustments for work-in-progress. Source: NSI.

stocks were increased because of the larger share of finished products indented for export but not actually exported.

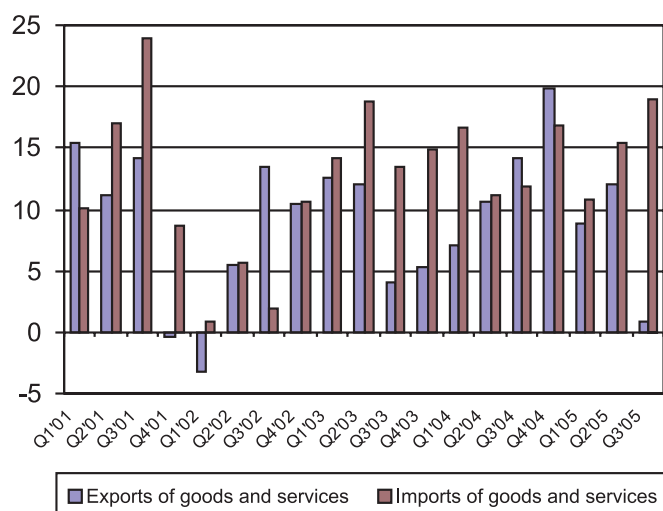
Table 1. Financing of gross capital formation

	Financing, total					Foreign savings
		Gross national savings, total	Gross domestic savings	Current transfers from abroad, net	Foreign income, net	
In % of GDP for period						
Nine months 2005	26.6	14.7	12.9	4.2	-2.5	12.0
Nine months 2004	21.9	17.0	15.3	4.7	-2.9	4.9
Nine months 2003	20.3	13.6	14.2	3.5	-4.1	6.7
Nine months 2002	17.8	16.5	15.2	3.3	-2.0	1.4
Nine months 2001	18.4	14.2	13.5	3.6	-3.0	4.2
Total financing =100, %						
Nine months 2005	100	55.0	48.6	15.9	-9.4	45.0
Nine months 2004	100	77.8	69.8	21.3	-13.3	22.2
Nine months 2003	100	67.0	70.0	17.4	-20.3	33.0
Nine months 2002	100	92.3	85.1	18.6	-11.4	7.7
Nine months 2001	100	77.0	73.4	19.6	-16.0	23.0

Source: source: BNB, Balance of Payments, published, as at 12 December 2005; NSI, GDP, published as at 19 December 2005., and own estimates

Export/Import of goods and services. Following a span in the first half of the year 2005 when exports registered an accelerated growth and its growth rate exceeded the rates registered in the respective quarters of 2004, in Q3 just below 1 per cent more exports of goods and services was realized as compared to the exports in Q3'2004. This presents, in a nutshell, the scope of the macroeconomic consequences of last summer's unfavorable weather conditions.

Figure 2. Exports and imports of goods and services, real growth over the respective quarter of the preceding year, %



Source: NSI

Imports continued to grow at an accelerated pace also in Q3 in response to the need to find a balance between the delayed production rate and the sharply rising domestic demand. For the first time since 1996 (the time quarterly GDP data started to be published) the positive seasonal foreign trade balance for goods and the services was given a negative sign. The growth in the imports of goods and services by 19 per cent (following the 15.5 per cent for the preceding quarter and at 11.9 per cent for Q3'2004) resulted in a record- high share in GDP for summer months – 74.1 per cent, provided that the largest share ever registered so far is 62.3 per cent (in the summer of 2004).

Financing of investments. The increase of the share of capital formation in GDP to 26.6 per cent for the nine months (at 21.9 per cent for the nine months of 2004) is attributable to the increased foreign saving (to 12 per cent percent of GDP, against 4.9 per cent for the nine months of 2004) on the background of declining national savings (to 14.7 per cent percent of GDP against 17 per cent for the nine months of 2004). National savings are going down due to lower domestic savings while the contribution of net current transfers and net foreign income in government savings for the nine months remains relatively constant as compared to the nine months of 2004. For the nine months of 2005, national savings financed 55 per cent of investment (77 per cent for the same period of 2004) (Table 1).

## Current Account.

The current account deficit on the balance of payments is over twice as high for the ten months<sup>10</sup> since the beginning of 2005 as

<sup>10</sup> Source: BNB, Balance of payments, at 12 December 2005



compared to the deficit for the same period of 2004. Apart from the traditionally largest - and growing - negative contribution of the trade balance deficit, the current account deficit has also deteriorated due to the lower positive balances for services and current transfers. In spite of the increase in the positive balance for tourism, the deteriorated negative balance for transport and the reverse trend (from positive to negative) of the balance for "Other Services" have resulted in a lower positive balance for services and the overall negative contribution of this group to the current account movements. The only positive contribution to the current account movement is the smaller negative balance on incomes. The current account deficit for the period January- October 2005, reached 10.5 per cent of the annual GDP<sup>11</sup> (against 4.7 per cent for the same period of 2004 and 8.5 per cent for the entire 2004).

The trade deficit (FOB) grew to 15.1 per cent of GDP (for the ten months of 2004 it was 10.3, and for the entire year it was 14 per cent of annual GDP). About 18 per cent of the deteriorated trade deficit, which went up EUR 1180 m over the same period of the preceding year, is attributable to higher fuel prices.

The growth rate of exports has been decreasing, while the growth rate of imports has been going up. Exports (FOB) and imports (FOB) in nominal terms have grown as compared to January-October 2004 by 18.0 and 27.6 per cent, respectively. After adjusting for the higher prices of crude oil, petrol products and natural gas, the increase in imports and exports are recalculated at 14.7 per cent and 22.5 per cent, respectively. The movements in exported and imports are best demonstrated by comparing data for the ten months with the increase on an annualized basis for the January-July period, by 19.0 and 24.2 per cent, respectively, and after adjusting for the price factor – by 16.5 and 20.4 per cent.

The negative balance between the import of crude oil, petrol products and natural gas and the export of petrol products grew to 5.4 per cent percent of GDP, at 3.6 per cent for the ten months of 2004.

The balance for services for the ten months of 2005 is positive, but going down as compared to the same period of 2004, and this movement has a negative contribution to the current account fluctuation. The decreasing balance of Services is attributable to the deteriorating balances on the "Transport" and "Other Services" items, which exceeds the growth in the positive balance of the "Travels" item. Thus, compared to the same period of 2004, the positive balance in services has gone down from 4.2 to 3.1 per cent of annual GDP, in spite of the fact that the positive balance for "Travels" went up from 4.9 to 5.0 per cent percent of GDP.

In 2005, revenues from travels have been going up at much slower rates as compared to previous years. For the ten months

of 2005, the increase in Euro revenues as compared to the same period of the preceding year was 9.1 per cent, about twice as slow against 2004 and 2003 when revenues grew by about 20 and 21 per cent, respectively, over the preceding year.

The negative balance under the "Income" has gone down (to 2 percent of GDP, at 2.3 for the ten months of 2004) due to the faster growth in income received and, more specifically, in income from portfolio investments, as compared to growth in income paid. Income received went up 29 per cent, with income from portfolio investments alone going up 82 per cent. Paid income is over twice the amount of income received, but is going up at a slower rate: by 6 per cent, mostly due to the growth in payments on Other Investments (by 27 per cent). Among the payments on direct investment, the fastest growing are payments on dividends (by 55 per cent). Payments on "Other Investments" are also up significantly – by 27 per cent.

In 2005, a downward trend is registered in the net inflow of current transfers in absolute terms. For the ten months of 2005, as compared to the same period of 2004, the net inflow of current transfers in absolute terms is 1.7 per cent down, and its share in GDP went down from 3.8 to 3.4 per cent. Proceeds from current transfers have only gone up 0.3 per cent, with government proceeds increasing by 19 per cent, but the proceeds from cash transfers, representing about 70 per cent of the total amount of proceeds from transfers, are down by 7.4 per cent. At the same time, payments on current transfers are growing faster (by 11.7 per cent), with government payments decreasing, and payments from others sectors going up by 15.8 per cent.

It is characteristic of the past 2005 that the coverage on the current account with foreign direct investments will probably stay below the 100 per cent mark and even below 2001 levels (82 per cent) - the only year in the 1999-2004 period that had a below 100 . For the ten months of 2005, the ratio is 65.8, at 152.3 for the same period of 2004, and 138.2 for the entire 2004.

## Foreign Trade

One of the indicators on the condition of the economy is *the rate of increase in trade*. The country's total trade volume for the ten months of the year exceeds EUR 19.5 b and demonstrates an increase in nominal terms by about 23.7 per cent over the same period of 2004. According to preliminary estimates, the value of trade for the entire 2005 will reach EUR 23.9 b, registering an increase of 22 per cent as over the entire 2004. Thus the ratio of foreign trade to gross domestic product, which illustrates the degree of integration of Bulgaria's economy into global economy, has grown from 103 per cent in 2004 to 119.5 per cent in 2005. The forthcoming EU accession, the harmonization of trade rules and practices, the expanding trade contacts with EU Member States, is an incentive for companies to invest

<sup>11</sup> GDP for 2004 – EUR 19,433.4 m (NSI estimates) and projected GDP for 2005 – EUR 21,183 m.

into increasing their production capacity and certification for international standards, thus putting in place the necessary conditions to further increase their trade volume.

*The export of goods (FOB)* for the ten months of 2005 shows an increase of 18 per cent over the same period of 2004 and exceeds EUR 7.7 b. Following a certain contraction in value of exports in August and September as a result of problems caused by the summer floods, October registered an increase of almost 24 per cent over October 2004. We have all reason to believe that this rate will be preserved and the value of exports for the entire 2005 will reach EUR 9.4 b. *The rates of increase in imports* have been ahead of those for exports during the entire year. For the first ten months of the year, imports went up 27.6 per cent, with its value of EUR 11.8 b (CIF) exceeding the value for the entire 2004. In October alone the increase is 34.5 per cent over the same month of the preceding year. In our expectations, the overall increase for 2005 will stay within the 25-26 per cent range, and the import value will reach EUR 14.5 b. Thus the *foreign trade deficit* (exports FOB – imports CIF), which for 2004 reached EUR 3.6 b, or 45 per cent of exports, for the ten months of 2005 is already EUR 4.1 b. (53 per cent of exports) with a tendency to reach EUR 5.1 b (54 per cent of exports) before the end of the year.

*The product structure of exports* registers a trend of gradual increase in the share of goods with higher added value. Thus for example the value of investment goods exports for the ten months of 2005 went up nearly 37 per cent as compared to the same period of 2004. Thus their share reached 15.3 per cent, at 13.2 per cent an year earlier. The growth is particularly noticeable (over three times) for vehicles, now exceeding 15.5 per cent of investment goods exported. It is no surprise that the largest increase (by nearly 48 per cent) was registered in the export of petrol products as a result of the sharp increase in prices. Ultimately this lead to a contracted share of consumer goods and raw materials in Bulgarian exports. This was also due to the barely preserved level of clothing and shoes exports in an environment of strong competition as a result of the expansion of Chinese products in the global market. These now account for a little over half of consumer goods exported, at 2/3 in 2004. As regards the export of materials, although the price of ferrous and non-ferrous metals remained high throughout 2005, the restructuring of production installations at Kremikovtsi after it was purchased by Mittal and stopping part of the plant for reconstruction lead to a decrease in the export of ferrous metals by 4 per cent. At the same time, the export of non-ferrous metals continued up, by nearly 23 per cent, and is already ahead of ferrous metals, in terms of value.

With the planned finalization of the restructuring of the majority of Bulgarian enterprises and the continuing construction of new plants, *exports will continue on its stable growth* at a rate of over 20 per cent a year. Both the current positive developments in the business situation in the Euro-Zone and the expected increase

in demand on the European market, and the adjustment of Bulgarian products to EU standards and requirements with the subsequent diversification of export markets, serve as a favorable background for such developments in trade. In 2006, some of the large production enterprises financed with foreign investment are expected to become operational and start exporting finished products (Sisejam, for example). Many of the “greenfield” enterprises are export-oriented, so when they are completed and reach planned production capacity, this is expected to impact on the country’s overall export rate. Others, which started with only a limited production are now expanding their activities and export volumes.

Changes are also observed in the *product structure of imports*. The most important change is the sharp increase by 52.6 per cent for the ten months of 2005 in the value of energy resource imports, which results in an increase of their share in total imports from about 17 per cent to 20.3 per cent. A change no less important for Bulgarian economy is the increase by over 34 per cent in the imports of investment goods, almost half of which are machinery, plant, and equipment. The imports of consumer goods and raw materials are growing at a much lower rate. Consumer goods remain the only product group with a positive trade balance.

No decrease in the growth rates of imports is to be expected in the near future. The reasons behind this can be sought in several different aspects. In the first place, the further increase in consumption (private and productive) due to the stabilizing economy and increase in incomes. With economic growth of 5.5 per cent in 2006 forecasted, no decrease in imports is to be expected but the growing share of investment imports gives us reason to hope that exports will grow at higher rates and a portion of domestic consumption will be supplied from products of the newly established enterprises. This should lead to a contraction (although slowly) of the trade balance deficit. The second reason is associated with the lack of local raw materials – the exports of processed products (for example metals) require the imports of raw materials (ores and concentrates), because many of the branches of Bulgarian industry operate mostly on imported raw materials. At the same time however for many production types (textile, machine-building, electric equipment, electronic products etc.) it is fully possible and even necessary for the local production of supplies, materials and semi-finished products to increase. Investment in the production of local plant supplies will facilitate Bulgarian producers and will result in lower production costs and their improved competitiveness in foreign markets. A reason to expect an increase in imports in the course of 2006 are also the commitments to be met by businesses before Bulgaria’s accession to the EU. And last, but not least, is the launching of several large investment projects in energy, machine-building and other sectors of the economy. Also continuing is the process of outsourcing of various productions in the country, which results, too, in the simultaneous increase in foreign investments and imports.

With regard to the *geographical structure of foreign trade* changes are relatively less and not so significant. In the first 10 months of 2005, 57.6 per cent of exports went to the EU, against 55.9 per cent one year earlier. The ranking order of key markets for Bulgarian export products is not changed: Italy, Germany and Greece, with these three countries accounting for 56 per cent of exports to the EU. Exports to the ten new Member States are up nearly 50 per cent over 2004 values. Balkan countries are the second most important region with 21.5 per cent of the total exports. More than half of Balkan exports go to Turkey, followed by Romania and Serbia and Montenegro. The most important change with regard to imports has to do with imports from Russia and China. As a result of the increased petrol prices on the international market, imports from Russia are up 56 per cent within one year. Thus, while in 2004 Russia accounted for 13 per cent of imports, in 2005 this share is already almost 16 per cent. Imports from China are also up over 50 per cent although it is still not a significant value as a relative share. The developments described above resulted in the EU share in imports falling from 54 to 49 per cent only within the space of a year. The major suppliers continue to be Germany, Italy and Greece, accounting for 55.5 per cent of EU imports. Imports from the ten new EU Member States are also going up fast: by 21.1 per cent against 16.2 per cent for the EU as a whole.

## Foreign Direct Investments

The stable economic environment, the relatively good rate of return and manageable risks for investment in the country continue to attract foreign investors. Practically all international observers share the opinion that the considerable volume of foreign capital that has infiltrated the country and continues to grow is a sign of the high marks given to the potential of Bulgaria's economy to grow and provide good opportunities for business development. This explains why the rate of increase in investments (local and foreign) has doubled over the past 3 years.

According to preliminary estimates for the ten months of 2005, over EUR 1,465 m in investments have entered the country, against 1,399 m for the same period of the preceding year. The increase is only 4.8 per cent, but for the first time this only includes greenfield investments, without a single privatization deal. Investments for the year are expected to reach EUR 2.2-2.3 b (as much as 2004). All financial resources are channeled towards the establishment of new enterprises and expansion of existing ones. There is a trend for an increase in investments in industry and energy, telecommunications and infrastructure. Following the amendments to the Investment Promotion Act and the establishment of new thresholds for project investment (BGN 70 m for Class One investment, BGN 40 to 70 m for Class Two investment and BGN 10 to 40 m for Class Three), the Investment Agency issued 10 certificates to the largest investors – 8 for Class One and 2 for Class Three investment.

Taking into account the foreign companies' declared intentions to invest in the country, the forthcoming start of one of the largest projects in energy (Maritsa-Iztok 1) and the finalization of some of the closed privatization, investments in the amount of EUR 2.5 b are to be expected in 2006. Bulgaria continues to be a location attractive to investors from the point of view of the profitable ratio of invested capital to production costs because of the cheap and relatively skilled labor and the legislation harmonized with the *acquis*. There are still many niches vacant and outsourcing opportunities therefore this activity is expected to grow 30-40 per cent in 2006.

## Inflation

**Consumer prices.** In November, consumer prices were 6.9 per cent higher on an annualised basis (over November 2004). The inflation accumulated over the eleven months of the year is 5.6 per cent (movement of consumer prices in November 2005 over December, 2004) and is already above the latest AEA forecast<sup>12</sup> for a 5.07 per cent increase in prices at the end of 2005 (December over December). The latest BNB forecast<sup>13</sup> on inflation at the end of the year is between 5.4 and 6.5 per cent. We expect that in the absence of a high contribution of administrative prices in December and under the influence mostly of the seasonal prices increase for food products, the total inflation rate for December will be no less than 0.8 per cent, and respectively the inflation will reach 6.4 per cent at the end of the year.

Average for the January-November period the increase in consumer prices over the respective period of 2004 is 4.9 per cent, which exceeds the expected annual average inflation forecast by AEA (4.71 per cent) and is practically the same as the BNB forecast (5 per cent).

In 2005, the monthly fluctuation in consumer prices was mostly dependent on the movements in market prices for consumer goods and services (Figure 3). Their share in the 2005 consumer basket was 78.6 per cent. The share of non-market (regulated) prices is 21.4 per cent, they are up 6.04 per cent since the beginning of the year. The highest monthly contribution (0.32 percentage points) was registered in the general inflation for November, when the new prices of heating, approved in September, were introduced.

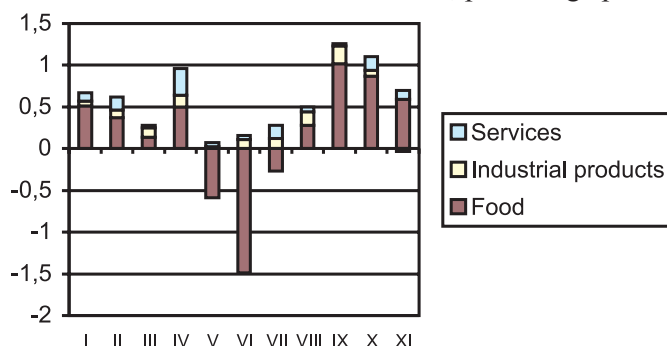
According to AEA estimates, at the end of 2005 the contribution of market and regulated prices in the general inflation is distributed in 82/18 per cent ratio, respectively, and for 2006 the distribution will probably be about 40/60 per cent. The changed ratio is mostly attributable to the government's excise duty policy during the year aiming to accelerate the fulfillment of the country's commitments made as part of the EU

<sup>12</sup> Source: AEA, the Bulgarian Economy: Analysis and Outlook, October, 2005

<sup>13</sup> Source: BNB, Economic Review, November/November.

pre-accession process. Thus the increase in regulated prices in 2006 is expected to be 14.47 per cent, and the expected contribution to overall inflation – 3.08 percentage points, while the increase of non-regulated (market) prices is expected to be 2.69 per cent, with a contribution of 2.12 percentage points.

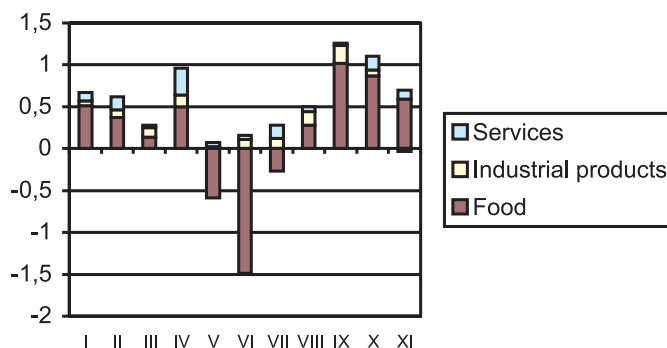
Figure 3. Contribution of market and non-market inflation in total inflation, percentage points



Source: NSI, AEAf

The fluctuations of market consumer prices in 2005 were mostly attributable to the change in food prices (Figure 4). Food products contributed 37.9 per cent to the consumer basket in 2005, and market consumer prices had a 48.2 per cent contribution. Food prices have gone up 4.93 per cent since the start of the year.

Figure 4. Contribution of price change by groups of goods and services to market inflation, percentage points



Source: NSI, AEAf

Table 2. Expectations in the respective month of 2005 for an increase in the selling prices in the course of the next three months

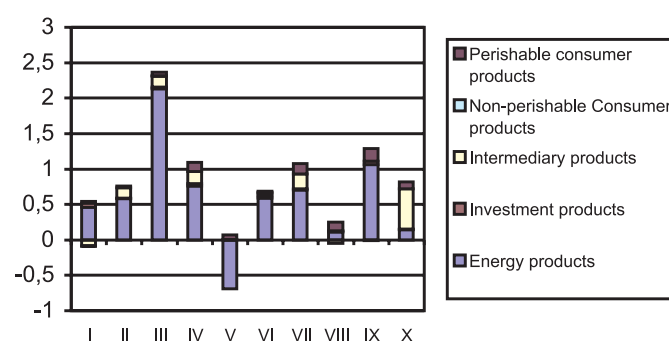
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Industry	yes	no	yes	no	no	no	yes	yes	yes	yes	yes	no
Construction	no	yes	yes	yes	yes	yes	yes	no	yes	yes	no	no
Retail trade	no	yes	yes	no	no	no	yes	yes	yes	yes	yes	yes
Services (retail trade excluded)	no	no	yes	yes	yes	no	yes	no	no	yes	yes	no

Source: NSI, Business Conjunction Monthly Business Surveys in 2005 and own conclusions

**Producer prices.** Of note is the fact that, from the start of the year until September the monthly changes in producer prices in

industry for the domestic market were mostly influenced by the price change for the group of energy products. Apart from being the group with the highest price fluctuations, this is also the group having the highest contribution to the change in producer prices (Figure 5). In October however the prices of intermediary products registered a sharp increase (by 2.24 per cent) and the contribution of this size class (0.57 percentage points) to the general index (0.83 per cent) also grew. This, in our opinion, is attributable not only to the repercussions of higher fuel and energy prices, but also to the response to the loss suffered from the summer floods.

Figure 5. Contribution to producer prices fluctuation over the previous month by groups of products, percentage points

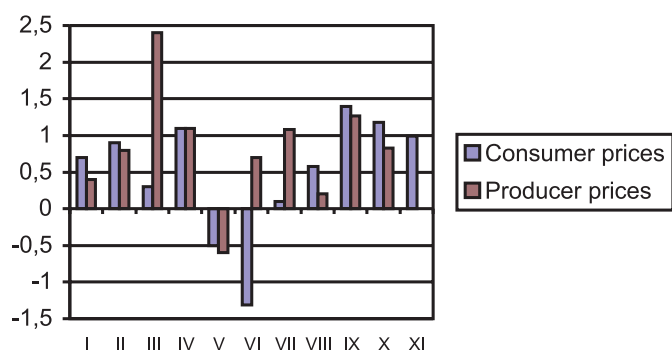


Source: NSI, AEAf

In the last three months of the year, and also during the third quarter, NSI business surveys registered the presence of inflation expectations for the next three months, with a certain slow-down in December (Table 2). Thus in December managers in industry expect no increase in the selling prices over the next three months, in construction inflation expectations remain at their November level, an increase in inflation expectations is registered in retail trade, and the services sector reported expectations that the price levels will be preserved in the course of the coming months.



Figure 6. Change in consumer prices and producer prices in industry on the domestic market, previous month = 100 (%)



Source: NSI, AEF

## Employment, Productivity and Unemployment

In spite of the temporary delay in productivity and its lagging behind employment growth in Q3 of 2005, the trend for slower year-over-year increase in the number of people employed (2.4 per cent against 3.1 per cent for Q3'2004) is accompanied by a faster decrease in the number of unemployed (by 16.1 per cent, against 12.5 per cent for Q3'2004)<sup>14</sup>.

**Employment.** While in the first half of 2005 the number of economically active people<sup>15</sup> decrease relative to the corresponding periods of 2004, Q3 registered an increase by 13.4 thousand people, which is attributable to the higher increase in the number of people employed - by 73.5 thousand, relative to the smaller decrease in the number of the unemployed, by 60.1 thousand. From the total of 3411 thousand active people, 99 per cent are aged 15-64 years.

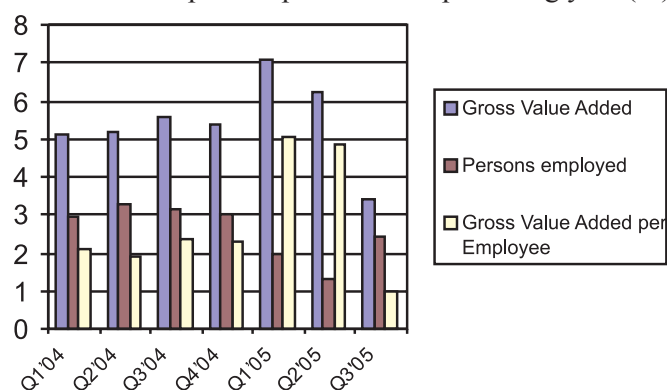
The number of economically inactive people has decreased by about 25 thousand relative to Q3 of 2004. 58.8 per cent of the total of 3260 thousand economically inactive people are in the 15-64 age group. The number of discouraged people has gone down to 334 thousand and is now 37.5 thousand less relative to Q3 of 2004; its share in the number of economically inactive people is also down - from 11.3 to 10.2 per cent, respectively. Within the breakdown of discouraged people by degree of education, the share of people with primary and lower education is increasing, from 56.6 to 60.2 per cent respectively, as well as the share of university graduates - from 5 to 5.4 per cent, respectively.

The number of people employed in the private sector has increased by 110.7 thousand, which is attributable to the considerable overall increase in the number of employed people (by 138 thousand) and the simultaneous decrease in

the number of all remaining categories of employed individuals - employers (by 0.9 thousand), self-employed (by 14 thousand) and unpaid family workers (by 12.5 thousand). These changes are probably reflecting the processes of consolidation in entrepreneurship and the more market-oriented relations established in the field of employment.

**Productivity.** The sharp, and, to a large degree, force-majeure slowing down in the growth of value added in the economy during the third quarter broke the trend since the beginning of 2005 of leading growth in productivity (value-added per person employed) relative to growth in employment (Figure 7).

Figure 7. GVA, persons employed, and GVA per person employed, total for economy - growth over the respective period of the preceding year (%)



Source: NSI, national accounts data and labor force surveys, and own estimates

**Unemployment rate.** Throughout 2005, the number of unemployed people continued to drop, with the figures from labor force surveys (LFS) and the Employment Agency data being very close. In Q3 of 2005, the unemployed according to LFS are 312.9 thousand, or 60 thousand less than during the same period of the preceding year, and the unemployed people registered by the Employment Agency in November were 383.9 thousand, or about 56 thousand less. As a result, the unemployment index calculated using the LFS methodology, is now a single-digit number: 9.2 per cent, and under the EA methodology, it is 10.36 per cent and will probably also soon shrink to a single digit.

The number of long-term unemployed people (1 year or more) according to LFSs in Q3 was 193.2 thousand and lower both relative to the preceding quarter (201.2 thousand) and relative to the same period of 2004 (226.2 thousand). The increased share of long-term unemployed in the total number of unemployed individuals is explained (to 61.7 per cent relative to 60.4 per cent for the preceding quarter and 60.6 per cent for Q2 of 2004) with the diminishing job opportunities for individuals who dropped out of the labor market for a longer period of time. It is worth noting that if we were to calculate the average number of people unemployed for over 1 year, based on the monthly reports of the Employment Agency, the figures for this category

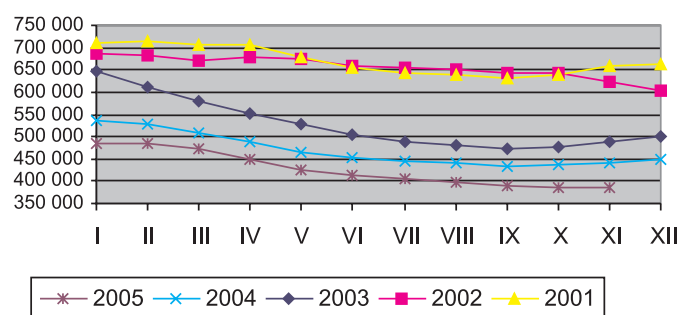
<sup>14</sup> Source: NSI, Labour Force Survey=

<sup>15</sup> Economically active population consists of individuals at the age of 15 and above who employ (employed individuals) or offer their labour (unemployed individuals) in the production of goods and services.

of unemployed is quite higher – almost 224 thousand, or an increase of over 30 thousand relative to LFS data for the same group. This comparison again leads to the assumption that the difference between LFS-reported unemployment and the EA figures is due to the temporary or undeclared employment of people officially registered as unemployed (for example, in Q3 the total difference is about 85 thousand people more for the registered unemployed).

According to data supplied by the Employment Agency, since August the number of registered unemployed people has steadily remained below the 400 thousand mark (Figure 8).

Figure 8. Registered unemployed people, number



Source: EA

New developments and the analysis of the business climate in Q4 are shown in two aspects: based on the Estat Index of Business Climate and based on the NSI monthly business surveys which, in spite of some methodological differences, successfully supplement each other while showing two different perspectives.

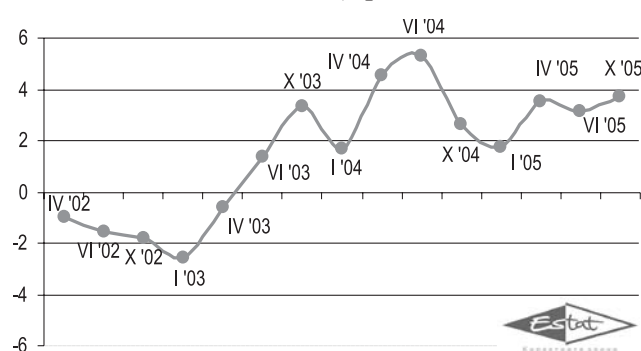
## The Estat Index of Business Climate, October 2005.

In October 2005, the Estat Index of Business Climate in Bulgaria reached its highest value for the year – 3.73. This figure is, however, considerably lower than the approx. 5 points registered in the middle of 2004. The fact that the maximum value was registered in autumn instead of summer is mostly attributable to managers' uncertainty associated with the general elections and the difficulties surrounding the new government in July and August.

The index value registered in October is the result of the year's highest figures for investment attitudes (25.9), in combination with the satisfactory, almost unchanged condition of companies and the traditional skepticism vis-à-vis state policy in the economic sphere.

In the first months of the Stanishev Cabinet, feedback on the condition of the business environment is much the same as that received at the end of the term in office of the government headed by Saxe-Coburg-Gotha.

Figure 9. Business Climate Dynamics (April 2002 – October 2005)



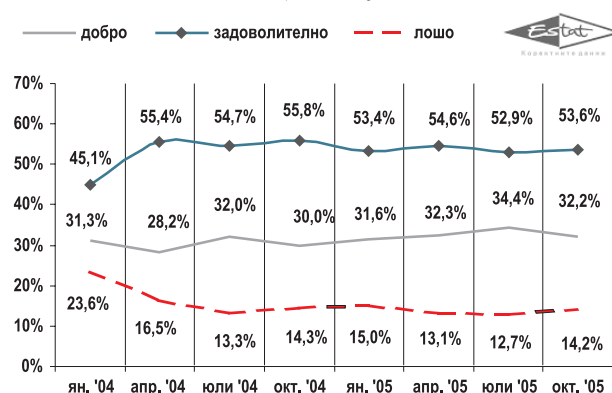
## 1. Company Component

In the course of the past 6 months, this component registered two drops, with its actual level being 9.92 – a value close to the average for the last 2 years. Following a short-lived rise in July of 2005, when for the first time the share of companies in “very good” and “good” condition exceeded one third of all companies in the country, now this value is again back to 32 per cent.

In the eve of winter, the share of entrepreneurs forecasting that the condition of their companies will deteriorate is going up. Quite naturally, such attitude is typical of autumn, but the

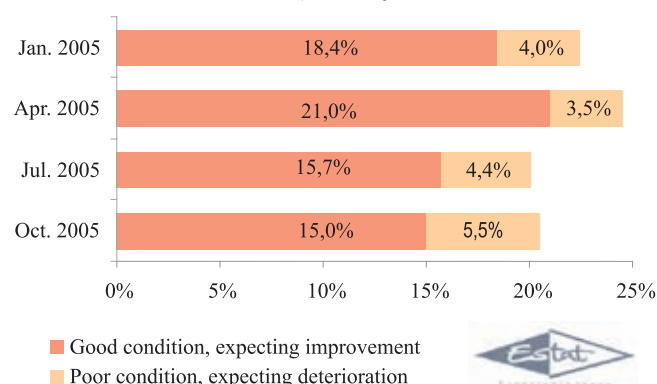
fluctuations are larger than usual and we can hardly explain the growing skepticism by the change of season alone. Thus for example between July and October the share of those who forecast considerable deterioration went up from 0.2 to 2 per cent of company managers. The percentage of those expecting certain deterioration goes up from 10.5 to 16.8. ESTAT survey has never registered such growth in pessimism in its entire 4 year-long history.

Figure 10. Dynamics in the condition of businesses (January 2004 – October 2005)



This fact made us pay more attention to the very tale-telling ratio of “thriving” to “sinking” companies (Figure 11), which is within normal limits and, at least for the time being, gives us no reason to expect lasting negative developments in the condition of businesses.

Figure 11. Ratio between the companies in good condition with tendency to improve and companies in poor condition expecting deterioration. (January 2005 – October 2005)

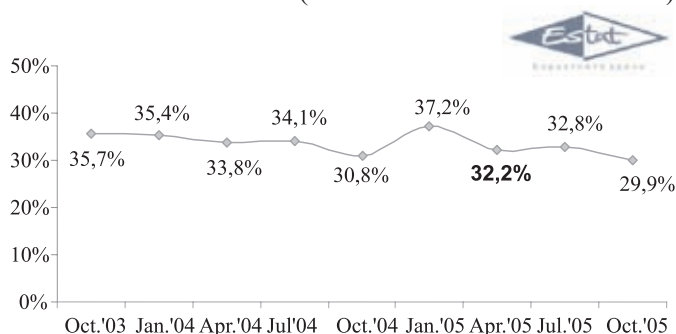


The survey in January will shed more light on whether this is a question of momentary reservedness and skepticism or of more serious problems.

The degree of managers' satisfaction with the quality of computers, software and information resources continue to go up. The latest survey registered the smallest share of companies with no Internet and information resources since 2002: 29.9 and 19.8 per cent, respectively (Figure 12). At the same time, an increasing number of entrepreneurs are rating

the condition of these resources as “very good” and “excellent”. It is possible however that businesses’ enthusiasm in respect of software and information products would shrink in the months to come because of the growing pressure to use legal software.

Figure 12. Share of respondents replying about the Internet „I have no such resource” (October 2003 – October 2005)

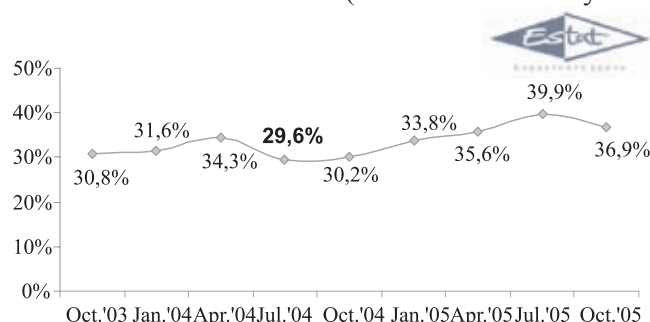


Survey data in 2005 show a tendency of ever-growing use of information and communication equipment and technology appropriate for the nature and activities of Bulgarian companies. At the same time, no change is observed in the share of companies using new technology; that is, progress in the IT field, for the time being at least, does not translate directly into positive developments for enterprises’ other resources.

No movement is registered also vis-à-vis the availability and quality of other resources, including financial and human resources. It can be safely assumed that the mini-crisis in liquidity and human resources have been - if not completely overcome - then, at least put under control to a certain extent. It seems that managers are now used to dealing with the deficit of working capital and qualified staff.

The companies which, according to the their managers, have no competitive advantages, and also the ones whose managers demonstrate enviable self-esteem by saying that they are ahead of competition on all counts, are within the normal limits established in the course of the past several years: 37 and 8 per cent of respondents, respectively .

Figure 13. Share of companies without a single competitive advantage (October 2003 – July 2005)

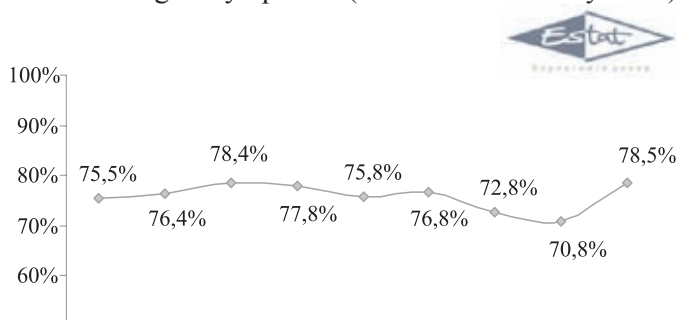


## 2. Investment Attitudes

After a downward turn in July, in October 2005 the value of the „Investment attitudes” component reached 25.9 per cent, this being the highest level for the entire year. It is close to the figures measured for the corresponding period of 2004 (24.6 per cent). It seems that in autumn investment attitudes make up for the reserve demonstrated in summer which was caused by certain political uncertainty.

This time, growth is not due to affinity to new technology, propensity for risk investments or readiness to take advantage of the bank lending boom. In the autumn of 2005, orientation to investment seems more rational and logical: there is a growing share of companies which follow long-term business strategies, and of entrepreneurs responding that they have partners on which their business depends in the long-term perspective. Both indicators are record- high in the entire history of the index since 2002.

Figure 14. Share of respondents agreeing with the statement „I have a business strategy, which I regularly update” (October 2003 – July 2005)



All remaining indicators are within their traditional limits. It must be noted however that although they do not seem to be deepening, the difficulties encountered in recruiting qualified workers and employees continue to be a serious problem for businesses. The percentage of export-oriented companies is again going up and, although slowly, interest to investment crediting is returning.

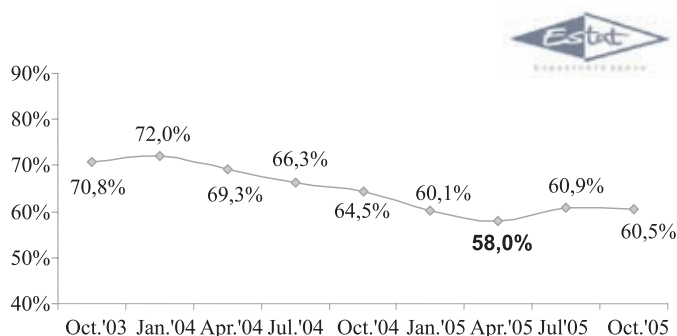
The share of companies whose managers respond that they exercise strict controls on the quality of products and services remains high. Such attitude is in sync both with the implementation of more complex marketing& planning solutions and with the growing market requirements and export orientation.

The almost year-long trend of declining confidence in the banking system seems to be history now inasmuch as, for two successive quarters now, the share of companies agreeing with the statement that the banking system is „stable and reliable” remains unchanged – about 49 per cent of respondents.



Throughout 2005, the share of companies working in an environment of working capital deficit remained almost unchanged – about 60 per cent. The current percentage of managers who responded they agree with this statement is 60.5 per cent. On the background of such problems the slight growth of interest in bank loans seems even less significant. In all probability, the companies that can afford such financial services have already done so and have no intention to be further indebted even if the risk is worthwhile.

Figure 15. Share of companies agreeing to the statement „I experience a shortage of financial resources needed for current operations” (October, 2003 – July 2005)



## 3. Environment Assessment

The value for this component registered a slight improvement of several tenths of a percentage point over the July levels – from -19.97 to -19.18. This result can, in practice, be interpreted as the absence of any change on this count.

Criticism to the government is mostly focused in the field of legislation and the legal environment. The share of those who agree with the statement that the government's legislative initiative is consistent and non-contradictory is going down while the share of entrepreneurs dissatisfied with the actual application of the laws is increasing.

However, opinions on the questions related to cumbersome bureaucratic procedures and business start-up barriers are moving in quite the opposite direction. On these indicators, the survey registered the highest score since 2002.

As compared to the summer of 2005, there are higher levels of tolerance vis-à-vis corporate and patent tax, but, on the other hand, up goes the share of entrepreneurs responding that social and health insurance contributions are a major burden to businesses – from 65 to 73 per cent of respondents.

Although it is still early days to be making optimistic conclusions, it should be noted that there is an increased share of businessmen agreeing with the statement that procedures under the Public Procurement Act are transparent and fair. The October business climate survey registered the largest number of respondents agreeing with this statement since 2003.

Figure 16. Share of respondents agreeing with the statement „Social and health insurance contributions are a major burden to businesses” (October 2003 – October, 2005)

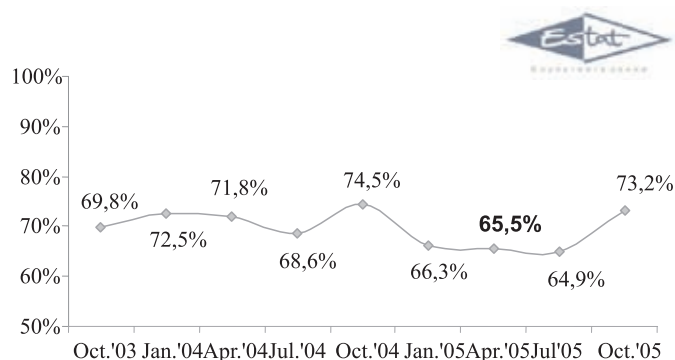
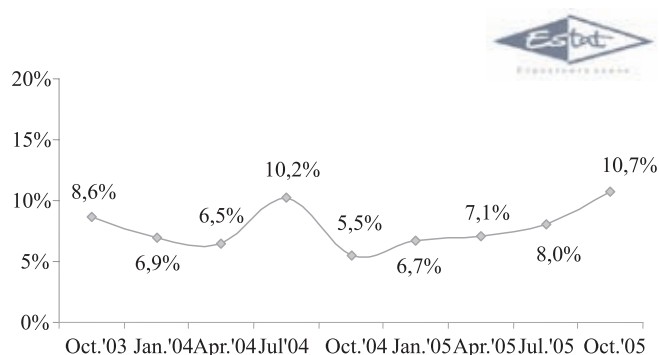


Figure 17. Share of respondents agreeing with the statement „Procedures under the Public Procurement Act are transparent and fair” (October 2003 – October, 2005)



## Business Climate in the Fourth Quarter of 2005 NSI figures<sup>16</sup>

The deteriorated overall economic outlook in country, following the 11- year long-term maximum reached in June, which was registered with the month-by-month decline of the general **business climate indicator** since July (by between 2.3-3.5 points) also continued in October when the indicator dropped another 3.6 points from its September level. In November and December we can assume that there has been certain stabilization in the business climate levels because the indicator in November was only 0.5 points below the October level, and in December it remained at November levels. Thus at the end of 2005 the business climate indicator fell below the average values for 2003.

All sectors monitored by the NSI business survey - industry, construction, retail trade and services (including transport) contributed to the lower levels in October. A point of attention

<sup>16</sup> Source: NSI, Business ConjunctureMonthly Business Surveys.

in November are the lower optimism values for the business climate in industry and in construction. It should be noted that during the separate months of the last quarter the precarious economic environment takes the foreground among the traditional factors impeding business activity in all monitored sectors.

A negative sign as regards growth potential is the fact that both the general and the compound business climate indicators in the monitored sectors are, generally speaking, below the levels for the respective months of 2004.

**Industry.** Between October and December, the composite indicator "Business Climate in Industry" fell consecutively by 2.6, then another 2.6 and 0.6 points below the level for the preceding month. Another factor that contributes considerably to the downward developments during the last quarter of 2005 is the shift in opinions on the current business condition of enterprises from optimistic to more moderate appraisals and expectations.

Of note is the fact however that both in October and November managers' opinions on the current and expected production activity remain optimistic. In addition, between July and October, the average production capacity load in industry went up 3.5 points and reached 65.7 per cent. During the same period, the inflow of new orders also increased which is accompanied by the improved competitive position of enterprises on the domestic market.

The lower score given to competitive positions on the external market in October and the more unfavorable export expectations were followed in November by lower scores to the current level of both foreign and domestic orders. Thus in December the current production activity was seen as "lower", managers' opinion on the number of domestic orders was low, and production secured by contracted orders production from abroad was assessed as being "sufficient".

The precarious economic environment increased its negative impact as a factor impeding business activity in industry.

**Construction.** For the last three months of 2005, the composite indicator "Business Climate in Construction" went down 2.9 and 2.6 points, respectively, and remains without change in December as compared to the previous month. Just as in industry, here, too, there has been a shift toward more subdued expectations about the business condition in the course of the following six months.

In October and November, construction activity was rated about the same level as the preceding months. In December, the opinion ratings are more moderate, and expectations for the following three months are more restrained than those in November. Nevertheless in December construction

entrepreneurs rated the production secured by contracted orders as "normal" for the season.

Competition in this industry was seen as a serious problem for construction enterprises throughout 2005. In October, major factors impeding business activity include "the price of materials" and "the uncertain economic environment"; in the closing two months of the year, financial concerns also move to the foreground.

**Retail trade.** Business climate in retail trade deteriorates more considerably in October when the composite indicator fell 6.3 points, kept at these levels in November and then went up, in the pre-Christmas period, 1.3 points in December. Here, too, the upward or downward movement is attributable, above all, to more unfavorable or heightened expectations for the business situation during the following six months.

Since October, the expectations on sale and supplier contract volumes for the next three months started to go down but they were more optimistic in December.

Rated in the same order for three months in a row, the major problems encountered by retailers are, first, inadequate demand, followed by competition within the sector, and the insecure economic environment.

**Services**<sup>17</sup>. After a downward movement in July, in October the composite indicator "Business Climate in the Services Sector" again went down 3.3 points due to the less positive outlook of current and expected demand in services. It started going up in November by 5.6 points because of improved opinions on the current business condition and expectations for the following six months. An increase of 2.3 points ensued due to managers' more optimistic expectations both about the business condition of enterprises in the course of the following six months and about the demand in services.

Competition is outlined as having the most weight among factors impeding the activity of service enterprises in the course of the past year.

<sup>17</sup> Without trade.

In 2005, measures were taken in the country to support entrepreneurship and improve the business environment. Some of the more important ones include: easing up the start-up of business with the adoption of the BULSTAT Act; implementation of projects in support of SMEs; faster and improved public procurement procedures, purposeful preparation for the Single European market etc. Another major development was the launching of the National Innovation Fund. New SME credit lines were established; European standards were introduced in several sectors; the Bulgarian Export Insurance Agency stepped up its activity. The government announced its intention to boost public-private partnerships in a number of areas. Meanwhile problems persisted or deepened in some key areas.

- The Government Program presented by the new cabinet does not set clearly enough the priorities in respect of structural reform, including the privatization and concessions of monopolies and infrastructure. It is possible that the limited resource of state-owned companies and the legal disputes over "major" privatization and concession deals would further slow down the structural reform in the country.
- Businesses are still not satisfied with the outcomes in terms of easing up of regulatory regimes and the implementation of ARARACEA.
- There still exists distrust in the objectivity and transparency of public procurement which should translate into further upgrading of the normative base and the capacity for its implementation.
- The major barriers that continue to impact negatively businesses and entrepreneurship are, to a large degree, associated with the state of the judiciary and the presence of corruption practices. The long-awaited reform of the judiciary failed to materialize during the past year. Although some progress was made, major developments in this field are yet to happen.

## Entrepreneurship and SME promotion

In 2005, the Agency for SME Promotion (ASMEP) continued to provide support to entrepreneurs by administering and promoting a number of projects and by expanding its activity through its local offices in all regional-centre cities in the country.

In the first place, the launching in 2005 of the *National Innovation Fund* (administered by ASMEP), should be noted. This is a pilot model to promote the technological upgrading and competitiveness of Bulgarian enterprises through fostering and introducing innovation. The project is a very concrete outcome of the willingness and efforts to promote the innovation and technological development of Bulgarian enterprises. Two sessions of presentation and approval of projects were held: in May and in October. The bulk of projects are in the hi-tech field

– instrumentation, robotics, machine-building, biotechnology. Interest in the Fund is growing and it is now one of the key mechanisms to improve SME competitiveness.

The implementation of projects launched during the preceding year continued in 2005. One of them is the project *"Establishing Competitive Start-Up Companies"*, also known as "Project 100". In 2004, on the territory of Dobrich, Vidin, Silistra and Shoumen a total of 67 new enterprises were established, each receiving a grant of BGN 5,000 to 15,000 for business start-up. In 2005, the project expanded its territorial scope to cover Montana, Pazardjik, Sliven, and Yambol. For competitive projects of start-up entrepreneurs in these regions the MEE provided financing of up to BGN 15,000. According the eligibility criteria, micro- and small enterprises have to co-finance at least 20 per cent of the project from their own budget.

Another project administered by ASMEP and MEE is entitled *"Support for Increasing the Competitiveness of Bulgarian Enterprises"*. As part of this project, EUR 30 m will be invested towards improving business services. The project envisages support to Bulgarian enterprises in using technical and consultant services and investing in equipment. The expected outcomes include achieving compliance with the *acquis* and international requirements. This project provides two grant schemes: one is for public-private partnerships and is intended for municipalities and non-governmental organizations, and the second scheme is intended for SMEs of the productive sector.

Currently, another MEE-administered project is underway which SMEs might find particularly attractive and useful. It concerns the introduction of the cluster approach and the establishing of a *pilot cluster model*. As a result of this project, several pilot clusters will be established in selected sectors; these will then undergo institutional capacity strengthening to allow the implementation of this relatively novel approach in sectoral and regional policy.

## Improving Business Strategies To Deal with the Competitive Pressure in the EU

The quality of Bulgarian companies' strategies is of major significance for improving their competitiveness in light of the forthcoming accession to the EU. In November, an analysis was published on the application of information technologies by Bulgarian enterprises and the impact of IT on their preparedness to deal with the competitive pressure within the EU.

The results of the study reveal that Bulgarian companies are not making sufficient use of advanced technology. This applies to SMEs to a very large degree – as few as 20 per cent of SME staff have basic computer skills, and employees with special qualifications in the area of information technology are only 5 per cent. The majority of SMEs are still in a process of acquiring computer peripherals and the participation of SMEs in electronic

commerce is still very low. Actual participation is limited to computerization but does not include network communication, and is only restricted to very basic Internet operations.

The size of enterprises significantly impacts the level of ICT use. In micro-enterprises, the application of such technology is about 25-30 per cent lower relative to the country average. However, of note is the fact that this gap has been shrinking over the past years, i.e. the rates of Internet use have been continuously growing precisely for micro-enterprises. The larger a company is, the more IT and Internet use increase. Data on Internet use reveal that about 25 per cent of the population and 75 per cent of companies in Bulgaria have access to the World Wide Web; it is, to a large degree, the basic means of communication. Over 32 per cent use the Internet for e-mail services, over 18 per cent – for interaction with institutions, as few as 6 per cent – for marketing research, and even less – about 5 per cent – use it for electronic commerce.

## ***Preparation for the Single European Market***

With the looming deadline for processing establishments in the milk and meat sector to close down (by end-2005 and the middle of 2006 respectively) if they fail to meet European market criteria, it transpired that only a small portion of these have been successfully upgraded. All establishments were divided into 4 groups depending on the stage of upgrading they achieved: those in Group One fully satisfy the requirements; establishments in the Group Two are approaching the finalization of their upgrading projects; a small part of establishments in Group Three have potential for development and have invested into introducing EU standards, while all remaining companies, as well as these in Group Four, will have to close down.

The fact that SAPARD funds remained blocked throughout 2005, the changes to EU hygiene requirements adopted in the meantime, and the financial and organizational difficulties faced by processing establishments left them in a position where they were unable to cope with the requirements. This forced the Bulgarian authorities to formally request from the European Commission a six-month postponement in upgrading the companies to satisfy European standards. The proposal for this modification also contained a list of specific enterprises for which the Bulgarian side considered deadlines should be extended. This will help protect the interest of companies which have already invested in achieving compliance and to which the continuing activity of non-compliant companies would represent an instance of unfair competition.

The National Veterinary Service has drawn up a timetable for upgrading establishments in the milk, meat, and fisheries sectors. A final evaluation of fish-processing establishments will be carried out between 1 January and 31 March, 2006. Between 1 April and 30 May a review of milk and dairy establishments

will be conducted, meat-processing companies will undergo a review from 1 July to 30 September.

At the end of 2005, bread and pastry micro-enterprises were given a chance to receive financial support from MEE to introduce HACCP. With the adoption of the Food Act, the HACCP system became mandatory for all enterprises in the food industry; however, there are hardly any certified companies in the bread-producing branch. Large enterprises have already started to invest but small and medium-sized, as well as the enormous number of micro-enterprises, are seriously falling behind.

The problem with the quality of raw materials gained new prominence in light of the need for food processing establishments to adjust to the food safety requirements. It is precisely the shortage of high-quality raw materials that hinders the compliance with European market requirements for most food industry sectors. The fact that attention was mostly focused on the processing industry served to further increase the gap between the current level of raw materials quality and the quality level necessary to ensure the smooth operation of upgraded processing establishments. To address this issue, the country made a commitment to submit, by 15 January 2006, a strategy on dividing milk into two categories: milk which meets European criteria, and milk which cannot satisfy EU requirements. Milk from the first category will be used for products marketed in the EU, and category 2 milk will undergo mandatory thermal processing and will only then be used in the production of dairy products.

On 1 September 2005, a new international standard was published – ISO 22000:2005 “Food Safety Management Systems – Requirements for Any Organization in the Food Chain”. It covers all producers of agricultural products and feed, processing establishments, food business operators, transport companies, warehouse operators, retailers and caterers, producers of equipment, packaging, additives. This standard is now compulsory along with HACCP. It aims to provide better protection of consumer health by delegating to producers the entire responsibility for the quality of products. For the time being, only 4 companies in Bulgaria have been certified for this new standard which is expected to boost confidence in producers and improve the Bulgarian companies’ reputation.

A draft Act on Amendments to the Food Act was submitted to the National Assembly; it introduces the latest EU directives on food control. The Ministry of Agriculture and Forestry established a register of foodstuffs of traditional specific character, i.e. those that have been produced for a period of at least 50 years from traditional raw materials. In addition to the food register, a register of food producers will also be kept. Amendments to the law also foresee the setting up of a single control body with coordination responsibilities: the National Food Safety Council.



## Trade Policy

In parallel with the work on commitments made as part of the country's EU accession effort, the government has set as its priority in trade policy the promotion of regional economic co-operation aiming to bring stabilization to the region and enhance the European integration of Balkan countries. A step in this direction was the revision, in late November, of the criteria for accession to CEFTA. The adopted changes considerably ease the admission regime for new members. Instead of the former requirements to countries: that they should be WTO members and have a valid EU Association Agreement, from now on the more lenient eligibility criteria will only require a strict commitment to abide by WTO rules and principles and the presence, as a minimum, of a Stabilization and Association Agreement with the EU. In this way, existing bilateral free trade agreements will gradually be replaced by a single agreement like CEFTA. Macedonia became the first country to join CEFTA under the new rules.

In compliance with the customs requirements, the duty tax on the imports of some goods - within certain quotas and for a certain periods of time - was either reduced or abolished. Because of the unfavorable weather conditions, import duty on grapes, gherkins and sweet peppers for processing purposes was dropped in order to boost the activity of processing establishments by giving them access to raw materials in larger volumes and of better quality. The increased domestic consumption of sugar and chocolate products and the increased export of confectionery resulted in the need to introduce an additional independent sugar import quota at 5 per cent duty tax (instead of 50 per cent). In this way the annual WTO-approved quota was increased from 250 to 270 thousand tons. In compliance with WTO commitments, starting from 1 January 2006, the customs duty was reduced on the imports of 15 types of goods, mostly hard-to-find raw materials for the processing sectors of the national economy.

## Privatization

The past year 2005 can be described as unsuccessful in respect of the Bulgarian economy's restructuring and privatization. According to the assessment given by international institutions such as the European Commission, the International Monetary Fund etc., Bulgaria is still facing difficulties in the liberalization of its economy. This appraisal particularly holds for the transport and energy sectors.

In the year of general elections in Bulgaria, the political decision-making process slowed down in the area of privatization, concessions, and demonopolization. The predominantly private ownership structure in industry, agriculture and tourism, and, at the same time, the significant ownership share of the state in sectors such as gas supply, railway transport, road infrastructure, and, in part, electricity generation and

transmission, lead to a deteriorated business environment and reduced opportunities for faster economic growth.

Bulgarian and foreign investors eagerly awaited the formation of the new cabinet and its priorities on structural reforms and the demonopolization of sectors strategic to the country. The cabinet's intentions in the area of state property management, privatization and concessions included in the government program are seen through the prism of "safeguarding public interests". Such wording, in combination with the timeframe provided in the program matrix, may be interpreted as an attempt to slow down structural reforms.

By the end of 2009, the program envisages "the exercising of ongoing control and regulatory impact on the implementation of the business programs of enterprises with majority state interest, and by end-2006 the activity of these enterprises will be analyzed and rehabilitation measures identified, including restructuring."

The text from the matrix quoted above can be interpreted as proof of the absence of sufficient political will to privatize the remaining state-owned enterprises, cut the loss from inefficient performance and encourage private initiative.

The commitments made by Bulgaria in the course of European Union membership negotiations include major structural reforms in the energy sector. The restructuring of NEC and Bulgargas and their consequent privatization are part of the negotiated terms. To date, the government has failed to send clear signals that these requirements will be met on time, by 2007.

There are also difficulties surrounding the restructuring and the sale of the cigarette monopoly, "Bulgartabac Holding". The options for a new privatization strategy for the holding are planned for discussion by the ruling coalition's Political Council. It is highly improbable that the privatization of this company should be finalized by end-2006.

The policy papers provide no response to issues of key importance to the economy: will healthcare and education be reformed and how will privatization in these sectors develop; is there sufficient political resolve for the fast restructuring and privatization of monopolies; will the ban on the sale of over 100 companies with majority state interest be dropped from the Privatization Program; when will the privatization be finalized for over a dozen large Bulgarian companies whose privatization strategies are awaiting approval by the Parliament.

The DSB group in the new National Assembly submitted a bill on the privatization of all healthcare establishments. The draft envisages that in-house doctors should benefit from preferential treatment in the privatization of health establishments. The Health Minister declared, on several occasions, the political will

to privatize only losing healthcare establishments. Most of the 300 state and municipal health establishments are in extremely poor condition while their indebtedness is sky-rocketing, reaching BGN 209 m for 2005.

***The fact that - for the first time since it was established - the Privatization Agency hasn't had its annual program for 2006 approved by the National Assembly, can also be interpreted as a sign of the insufficient resolve vis-à-vis the so-called "big privatization".***

At the end of 2005, according to figures supplied by the Privatization Agency, about 40 per cent of the Bulgarian economy is still owned by the state. For the entire 2005, 31 companies with majority state interest were sold, 8 autonomous parts and 201 share packages from commercial companies with under 50 per cent state interest.

The privatization deals for companies in the military-industrial complex did not see the expected developments in the course of the year: VMZ Sopot, Teraton, Kintex, the Bulgaria Air company, Bulgarian River Shipping, Navigation Maritime Bulgare, the CHPPs in Varna, Rousse and Bobovdol. Attempts to privatize Bulgartabac Holding and the ADIS diplomatic properties company proved unsuccessful.

The legal option to challenge in court the decisions of the state Privatization Agency and the lengthy court procedures further delayed the privatization process.

Privatization negotiations for CHPP Varna with the PA-selected buyer – the Russian company RAO United Energy Systems, ended in failure. The signed bilateral agreement between the two parties did not resolve issues related to the regulatory framework, the emission reduction plans and the modifications to the integrated environmental permit. The price proposed by the buyer was EUR 389.727 m. The PA Supervisory Board approved the draft agreement, and the candidate buyers stated in writing their decision to cancel the deal. Now the Privatization Agency has to decide whether it will continue negotiations with the bidder ranked second - the Czech company CEZ which proposed EUR 192.044 m for 100 per cent of CHPP Varna, or will call a new privatization procedure.

The Commission on the Protection of Competition ruled out the option for the Russian company to also purchase the assets of CHPP "Rousse". The final decision is expected from the Supreme Administrative Court where the CPC decision is being challenged by the Privatization Agency the managements of both CHPPs.

The PA Supervisory Board approved the draft privatization agreement on the sale of up to 95 per cent of the capital of "Boyana Film" EAD with New Image Bulgaria. The privatization

price is BGN 12.2 m and there are plans for investments in the amount of BGN 30.5 m.

In 2006, the state remains as the majority owner of 57 companies outside the so-called prohibited list, with assets being mostly in the energy and industry sectors, as well as 509 minority stakes or shares in privatized companies.

The volume of compensatory instruments continues to grow and at the end of 2005 securities worth about BGN 600 m were registered in the Central Depository. The privatization deals involving the sale of minority blocks of shares on the stock exchange which expected to assist the use of securities did not materialize. If Bulgaria becomes an EU Member-State in early 2007, and finalizes the privatization process, the association of owners of compensatory instrument believes that such instruments should be traded for government securities.

## Concessions

The Council of Ministers of the Republic of Bulgaria approved a draft Concessions Act. The draft act introduces a harmonized approach in awarding concessions by the state and by municipalities. The law regulates the following types of concessions: mining, services and work. The latter type of concession was, until then, regulated by the Public Procurement Act. According to the legal subject granting the concession, there will be state, municipal and public concessions. The procedures for granting concession will be selected depending on the specifics of the concession object and the business activity it performs; the volume and complexity of documentation; the number of expected bidders. The three types of procedures for the selection of concessionaires – open, restricted, and competitive dialogue – will be also supplemented by an online tender, to be applied to the first two types.

The draft act is expected to be submitted for deliberation by the National Assembly in February 2006. Some heated debate is expected on the option for concession contracts to be concluded without any tender or competition as is envisaged in the draft act.

A significant difference from the current Concessions Act is that there is no option to extend the validity of concession contracts, and also the absence of provisions under which at the expiry of the concession, other things being equal, the current concessionaire is to be given preference to other bidders in a new procedure.

The new Act also provides for an option to terminate concession contracts already in force in case that their unprofitableness can be proven.

## **National Concessions Register**

On 28 December 2005, the government published online the National Concessions Register kept by the Council of Ministers. At [www.ncr.government.bg](http://www.ncr.government.bg) 848 valid concession agreements are available to be traced – 559 of them are municipal, and 289 are state concessions. The concession agreements are described in detail, together with the property rights and obligations of the parties, the implementation responsibilities, the legal grounds and rights in the termination of the concession. In addition to the National Concession Register, another source of information is the concessions portal at: [www.conces.government.bg](http://www.conces.government.bg) which contains all laws, regulations and ordinances related to concessions, as well as the European Union directives and regulations.

## **Ports**

At its last session for 2005, the National Assembly adopted the amendments to the Act on Maritime Spaces, Inland Waterways and Ports. According to the amendments, starting from 1 January 2007, canal dues, ship's tonnage dues, load line dues, light dues and waste management fees paid by ships in ports for public transport of national significance, will be collected by the newly established state enterprise "Port Infrastructure". This company replaced the National Company "Ports" which was declared illegal by the court.

The fees and their dues for ports of regional significance – yacht, fishing ports and special-purpose ports, will be collected by the port owner.

This decision caused a negative response from all parliamentary groups. There is a strong belief that it serves to strengthen state intervention and financial centralization, and thus puts off investors. The channeling of resources form "Port Infrastructure" to state-owned ports corrupts the competitive environment and is in conflict with the rules of market economy and good European practices.

The proposal made by several large companies such as "Solvey Sodi" AD, "Devnya Cement" AD, "Kaolin" AD etc., which receive over 85 per cent of their cargo through port Varna-West and are interested in the granting of concessions on other terminals, too, envisaged for port operators and concessionaires to collect a portion of the mooring and ship's tonnage dues, as well as the waste management fees, and use the resources to maintain the port infrastructure.

On 3 November 2005, the Council of Ministers approved the concessionaires for the port terminals in Svishtov, Oryahovo, and Balchik, proposed by the Ministry of Transport.

These are the Bulgarian companies "Slanchev Dar" for Oryahovo, "Dragajen Flot Istar" AD for Svishtov, and "Port Balchik" AD for Balchik.

In December, the concession agreement was signed for port Balchik, an autonomous part of the port for public transport Varna. The port handles grain cargo mostly. The new operator will invest a little under BGN 3.5 m in the next several years, pay a one-time concession charge in the amount of BGN 392 thousand and a flat annual concession charge of EUR 144,500.

The government also announced the winner in the one-tier non-attendance tender for award of concession of the Silistra ferryboat terminal which is a territorially autonomous area of the port for public transport with national significance Rousse. A portion of the terminal will be constructed with funds from the concessionaire.

The Council of Ministers called of the concession procedure for terminals "Vidin-South" and "Ferryboat Complex Vidin" because no bidders appeared. The facilities granted under concession are public state property with national significance and future concessionaires were expected to improve the cargo inflow and invest into the modernization of the port infrastructure. Due to the fact that not a single application was filed, the government also called off the concession procedure for "Port Container Terminal Varna-West".

The Ministry of Transport is drawing up a national strategy for transport infrastructure. The program includes the identification of territories for future expansion of the ports and the subsequent granting of concessions. The underlying concept is to also use concessions of the build-operate-transfer type. Until now concessionaires were restricted to a very limited territory for development of the companies. This was the reason for the calling-off of concession procedures for ports which were still at an initial stage of development.

## **Airports**

In early December 2005 the Supreme Administrative Court considered new evidence on the case filed on the petition of the Ministry of Transport and the Copenhagen Airports A/C company, winner of the non-attendance competition for concession of the civil airports for public use in Varna and Bourgas. The drawn-out legal dispute led to a delay in the process of renovation of the two airports. This is to the detriment of the state, which will now have to invest - instead of let concessionaires do that - into the construction of temporary terminals to cope with the increased passenger flow.

The Ministry of Defense transferred the right of management of the military airport in the village of Shtraklevo, Rousse region, to the Ministry of Transport, which in turn declared Shtraklevo a

civil airport intended for public use. The procedure for drawing up the company's legal and financial analyses is currently underway in preparation for the concession competition.

The opportunities for other military airports to be used for civil purposes are being discussed in the context of the investor interest. The airport at Gorna Oryahovitsa is one of the five airports in Bulgaria of international statute. In recent years it is used for cargo flights and tourist charters to Veliko Tarnovo. A decision of the Council of Ministers is expected on the transfer of ownership.

The Ministry of Transport has declared its willingness to grant concession of the airports in Uzundjovo, Stara Zagora and Rousse.

## *Roads*

The concession agreement for Trakia motorway is awaiting the decision of the Supreme Administrative Court. Meanwhile the Commission on the Protection of Competition granted its approval for the concession agreement.

A Working Group under the Council of Ministers is working on a National Program for completion of the motorways in the country. It is envisaged that only one motorway, "Maritsa" would be financed from the budget while the remaining motorways – "Cherno More", "Strouma", "Hemus" and "Trakia", would be constructed by concessionaires.

The deadlines for completion of construction works for motorways are as follows: "Trakia" – 2008, "Cherno More" – 2010, "Strouma" – 2010, Sofia–Nish – 2008, "Maritsa" – 2008. No deadline was given for the completion of the "Hemus" motorway.

## *Ores and Mineral Deposits, Inert Material*

The government granted concession for extraction of industrial materials in the Suhata Reka deposit located on the land of Velingrad and Rakitovo. The concessionaire "Ramovo" OOD, will invest a minimum of BGN 33,200 for the first 5 years of the concession.

The sand deposit Hydroecopim -1 on the land of the village of Chelopechene, Kremikovtsi district, and the village of Chepintsi will be granted under concession to the Hydroecopim OOD company for the extraction of materials in the production of concrete and road slabs.

The Verona industrial materials deposit is awarded under concession for a period of 35 years and investments of nearly BGN 2 m for the first 5 years of concession. The concessionaire is the Oropack OOD company.

Approximately BGN 1.4 will be invested into the prospecting of ores in the Laki. The company "Laki Invest" AD will prospect a total area of 6.87 sq. km.

By a government decision, the company "Bulslate" OOD will prospect for a term of 2 years the extraction of tiling materials in the Hoazlaka area near the village of Gorna Kula, Krumovgrad municipality. BGN 14,700 will be invested for a geological report, mapping, laboratory analyses.

The American company CBM Energy, active in the exploration and prospecting of natural gas in Block 21 ДББ (Cyrillic), which has invested to present USD 2.7 m into geological prospecting activities, was granted a 2-year extension period for the prospecting for natural gas. The company will invest another USD 5 m into the implementation of its operational program.

The government is taking steps to collect the overdue concession fees and default payments from "Gorubso-Madan" AD, Kardjali. These are due under concession agreements for lead and zinc ore mining in the Krushev Dol and Petrovitsa deposits, Smolyan Region. Overdue liabilities total USD 32,610.84.

## *Beach Strips*

As part of the discussions on the new Act on the Black Sea Coast, the mayors of coastal municipalities proposed that the state should transfer to the local authorities the right to grant concession of the beaches. By law these are exclusive state property and are awarded by regional governors. The mayors' proposal contains no intentions for change in the ownership and is justified by the current cumbersome procedure and the concessionaires' unwillingness to maintain the beach strips all-year-round.

## *Game-keeping Holdings*

Changes were prepared to the Hunting and Game Preservation Act. According to these, the state will be able to award concession for a period of up to 15 of some of the state-owned game-keeping stations and state-owned hunting areas. The authors of these draft amendments claim that these hunting areas are not profitable and the state does not have the financial resources necessary to support them. The purpose is for concessionaires to invest into improving the flora and fauna and increase the game numbers.

## *Improvement of the Business Environment*

### *Business start-up. Regulatory Regimes*

Although some procedures were sped up, new business start-up continues to be a problem to entrepreneurs and is still one of the areas most often subjected to criticism.



Several recent developments are of major importance to improving the business environment and, above all, to enhancing and streamlining the company registration procedures.

## BULSTAT Act

A step towards simplifying company registration is the adoption of the *BULSTAT Act*<sup>18</sup>. With this Act, company registers are transferred from the National Statistics Institute to the Registry Agency. Another important issue now settled by the new law is that the BULSTAT number will be a *uniform number* replacing all existing tax, social insurance and customs registration numbers.

This will beyond doubt have positive impact on the business environment and is, in essence, the practical implementation of the one-stop-shop concept. Its benefits include: stepping up the process of registration and business start-up, saving time and red tape; avoiding the doubling of documents; a smaller number of loopholes enabling corruption practices. In essence, this Act marks the beginning of applying the concept of the single identification of legal entities.

The BULSTAT Act is a major step towards facilitating business start-up in Bulgaria. The next steps in this direction should be: introducing lower registration fees; an option for online filling-in and filing of BULSTAT Register applications; transferring companies' court registration to the Registry Agency; online access to information in the BULSTAT Register etc.

The adoption of the BULSTAT Act is a milestone in the process of reform in company registration and the establishment of an electronic register centre.

In mid-2005, the *Strategy for the establishment of a Central register of legal entities and an electronic register centre of the Republic of Bulgaria* was adopted. This is an attempt to introduce radical change vis-à-vis company registration. Work on the implementation of the Strategy is marking progress although it is accompanied by much criticism and conflicts between various institutions.

There are four stages in the implementation of the strategy objectives:

1. Establishing a Central Register of Legal Entities.
2. Establishing an Electronic Registry Centre.
3. Merging tax registers, vehicles registration, ESGRAON etc.
4. Establishing a central real property register.

*Central Register of Legal Entities and Electronic Register Centre of the Republic of Bulgaria*

The draft legislation on the establishment of the Register has been presented; according to its authors the major benefits include:

- Businesses will be registered within a day or two. In more complicated cases, for example joint-stock companies or company transformations, the registration will be finalized within a week.
- Registrators will not be entitled to subjective judgments, i.e. subjectivism will be avoided in the registration process. Officials will only have the right to reject documents in cases explicitly stipulated by the law.
- Anyone will be able to check quickly and easily the legal condition of his/her potential partner.
- Anyone will be able to receive in a timely manner any statements on his/her own company.
- There will be no ghost companies.
- The "shadow economy" sector will be reduced.

Along with its accessibility and public openness, the company register is also planned to be established as an information system with a single electronic database. There are plans for a fully functional electronic register available online to be up and running within 2 years. The registry applications will be filed with the territorial units of the Registry Agency operating within district courts.

According to the draft law, companies will be given a unique single identification number (SIN) similar to the Personal Identification Number for citizens. It will be assigned at the time of registration and will be valid until the company is officially deleted from the register. Currently, companies have a BULSTAT number, which is considered a secondary register. With the entry into force of the new law, companies will be deleted from BULSTAT and will only have a SIN.

The applications for registration, deletion or announcements will be reviewed immediately in the same order they were filed with the Register. Also expressly stated are the reasons for which registration can be refused – failure to pay a processing fee, documents containing irregularities or omissions, missing declarations etc.

Another advantage would be that according to the new law, anyone will be able to check anything in the companies' register. With the entry into force of the electronic register queries will also be possible online i.e. without having to visit the respective agency unit.

The authors of the Strategy and the draft law foresee that the new legislation will come into effect from 1 September 2006. From then on, all existing companies will be given a period of 2 years to change their registration and be issued with a SIN.

<sup>18</sup> In force since 10 August, 2005

The establishment of the electronic register will result in the elimination of ghost companies and companies which never did any business.

These are some of the key aspects of the draft legislation on the register. The register is planned to be administered by the Registry Agency under the Ministry of Justice.

As a whole, the adoption of the law will provide for much speedier company registration procedures – one of the areas in which Bulgaria is still lagging behind EU countries, where the requirements to new business registration are that it should not take more than 18 days.

Several discussions were held on the draft legislation in the last months of 2005. It brought about a serious clash of opinions between the courts which are currently entrusted with company registration functions, and representatives of the executive branch of authority to whom this activity will be transferred under the draft law. Court representatives claimed that taking company registration out of the judicial system will result in many problems and will be too expensive. They further claimed that the waiting period will be even longer, the duplication of companies will not be avoided, the issue of ghost companies will not be resolved, the degree of security of the registration will go down etc. There have been alerts about possible problems also coming from software companies claiming that the electronic registration would give citizens a lower level of security.

## *Opportunity to Transfer Administrative Services to the Private Sector*

A decision taken in March 2005 by the Public Administration Council is an important step toward easing up the regulatory environment. It foresees for a considerable portion of administrative services to be transferred to the private sector. The proposal involves 40-60 types of services mostly in the area of veterinary medicine, transport and communications, agriculture and forestry. The issue of establishing public-private partnership in the area of administering various types of services was put up for discussion a long time ago also by business representatives. The decision, which is expected to be put to practice in 2006, will probably result in saving time, less corruption and a considerable cut in red tape and public administration costs.

## **Public Procurement**

Upgrading the public procurement system continues on the agenda as a major challenge in the period leading up to Bulgaria's EU accession. It is necessary to improve the professionalism of both the contracting authorities and the contractors in public procurement. E-procurement should be introduced at enhanced rates and public-private partnerships should be promoted.

According to representatives of the business community, the new Public Procurement Act is not efficient enough, it leads to corruption practices and should be improved. Although it introduced in Bulgaria, to a considerable degree, the same rules and requirements to the award of public procurement as those in the EU, part of these provisions are not being implemented in practice. The fundamental problems arise from several facts: the contracting authorities often formulate their technical requirements in a such a way that only a limited number of companies meet the requirements; the contracting authorities apply unclear criteria to evaluate the tender offers; there is a loophole allowing several related persons to take part in the same procurement procedure under the PPA; enforcement control is inadequate; the deadline for taking in tender offers is too short; there are many barriers in the appeal procedure etc. In addition, small contracting authorities such as municipalities and health establishments often circumvent the Public Procurement Act.

In order to address the need for upgrading the legal base in the area of public procurement, in November 2005 the government adopted a *National Strategy for Development of the Public Procurement and Concessions Sectors* for 2005-2007. In drawing up the Strategy, the authors took into account the European Commission recommendations and SIGMA contained in their regular reports on the institutional development of the Public Procurement Agency and the public procurement system in the country, as well as the European Commission's recommendation for a joint review in the sectors of public procurement and concessions.

The major strategic goal is to establish the necessary conditions for compliance with the principles of openness, transparency, free and fair competition, equal treatment of all tenderers and the prevention of any discrimination of awarding public procurement and concessions. This goal will be achieved by following these priorities:

- upgrading the legislation in the area of public procurement and concessions and bringing it in line with the EU legal framework;
- strengthening and improvement of the administrative capacity;
- ensuring openness, transparency and equal treatment for all parties involved in the procedures of public procurement and concessions.

Achieving these priorities will result in the full harmonization of the legislation in these two areas with the *acquis* and will establish the conditions for the efficient enforcement of this legislation. The planned training will improve the qualification of experts working at the Public Procurement Agency (PPA), the competences of judiciary authorities and the effectiveness of controls.

The establishment of a public procurement register and a concessions register in compliance with EU requirements and practice will allow for more openness, transparency and equal treatment of those involved in public procurement and concessions.

The Strategy will be implemented with the active co-operation between PPA, the responsible institutions, the PHARE Program, USAID, the Institute for Public Administration and European Integration, branch associations and other non-governmental organizations, local and foreign partners.

The ultimate result from the implementation of the strategy will be achieving higher effectiveness in the spending of public funds, less corruption opportunities, a guarantee of macro-economic stability.

In implementation of the strategy, in December 2005 the government adopted a *draft Act on Amendments to the Public Procurement Act*. One of the key new proposals in the draft is that contractors will be selected via an electronic tender procedure. Public works concessions are planned to be taken out of the scope of the PPA; they will be governed by the Concessions Act. The range of contracting authorities in public procurement is also established in more precise terms. The Bulgarian National Bank will be a new contracting authority under the PPA. Until now it operated under the Ordinance on Tender Procedures and Competitions. A new procedure is introduced in public procurement: "competitive dialogue". It may be applied by a contracting authority in the public sector when the subject of public procurement is too complex and procurement is impossible to award under the open or restricted procedure. Also legally regulated is the conclusion of a framework agreement by classic contracting authorities. To date, only the so-called "sectoral contracting authorities" have been allowed to enter into such agreements.

Contracting authorities are obliged to send notices and information also to the European Commission when the public procurement value exceeds the thresholds laid down in the Directives.

The draft also contains provisions for the procurement by the National Health Fund of medicines from the reimbursement list for out-patient treatment to be governed by this act. According to health experts however this proposal will probably not be approved because in the case of medicines the procurement has a pre-defined volume.

In 2005, some positive changes were introduced in the organization of public procurement procedures.

A major step in the modernization of the public procurement system was the *launching of the Official Gazette webpage*, as

well as the new Public Procurement Register (PPR). Effective from 1 May 2005, amendments to the Official Gazette Act are now in force<sup>19</sup>, according to which public procurement notices under PPA are to be published on the Official Gazette webpage<sup>20</sup>. On the same date, amendments to the Public Procurement Act also came into force; according to them public procurement notice will be sent by the contracting authority in electronic form and will be published on the Official Gazette webpage within 5 days of their sending. These amendments will help avoid situations where the public procurement notice is published on the paper version of the Official Gazette only a few days before the final deadline for filing the offers, which makes it difficult for applicants to get ready.

At the end of May, 2005 the PPA presented the new *Public Procurement Register* (PPR) which was developed in cooperation with the USAID Open Government Initiative Project. The Register is public and access to its information is free. It represents a modern electronic database in which public procurement information is published and stored, thus providing public openness and transparency for the process of procurement award. It supports structured information on the decisions and notices for all public procurement, as well as information on contracts already concluded. Its structure was aligned with the e-government Strategy of the Republic of Bulgaria to provide electronically high-quality administrative services to citizens.

An important achievement towards greater transparency in procedures is that since early August 2005 PPR provides a new service: *online filing of tender notice forms*. It is accessible to contracting authorities having an universal electronic signature and are authorized users. The Public Procurement Agency webpage provides step-by-step instructions on how to register as an authorized user.

Regretfully, the number of contracting authorities owning a universal electronic signature is still quite small. Therefore the price cuts for e-signatures announced by the two suppliers of certification services – "BankService" AD and "Information Services" AD, last year will contribute towards the wider use of this new service.

The online filing of tender notices in public procurement circumvents the need to send documentation in paper form. This saves time and money both for contracting authorities and for experts maintaining the PPR. The risk of technical errors is also greatly reduced.

The Court of Arbitration at the *Public Procurement Agency* is now operational, although its Chairman was elected with some delay. The Court of Arbitration provides an alternative out-of-court method for dispute resolution in public procurement.

<sup>19</sup> Act on the Amendments to the Official Gazette Act, OG, No 31, 2005

<sup>20</sup> <http://dv.parliament.bg/>

The Regulation and Statutes of the Court of Arbitration were approved as far back as September 2004. The Chairman of the Court of Arbitration represents the court both in the country and abroad, takes decisions on organizational matters, coordinates the work of the Secretariat, summarizes the case law of the Court of Arbitration and submits it to the Executive Director of PPA for official announcement.

In early April 2005, the first ever *Public Procurement Manual* was published; it was prepared by PPA experts. It will be of assistance to the preparation of all participants in public procurement procedures.

The *Agreement for Cooperation and Interaction* signed by the National Audit Office, the PPA and PIFCA, is of major significance to the control on public procurement.<sup>21</sup> The goal is to help achieve the efficient spending of public funds, ensure adequate controls on the public procurement procedures and achieve coordination of all control bodies in this area.

## Reform in Public Administration

The modernization of Bulgarian administration is expected to continue with special focus on its upgrading in support of small and medium-sized businesses.

The reform in public administration is closely related to improving the administrative and regulatory environment for businesses. A policy paper entitled *White Book of Public Administration* that was officially presented in March 2005 is an important step in that direction. It formulates the key guidelines for modernizing the administration and provides a mechanism to maintain these guidelines in the years to come regardless of what government will be ruling the country. The goal is to achieve continuity and sustainability in reforms. The key priorities and policy lines in this area are outlined.

The *White Book* emphasizes that client-oriented practices must be given a priority when planning, managing and evaluating the process of modernization of public administration. This means reconciling to the best degree possible economic efficiency with the interests of citizens and businesses. Achieving this would first require developing clear quality standards, setting strategic goals, controlling the implementation of objectives by comparing the actual results on the basis of predefined indicators (strategic control). The purpose of such strategic control is to evaluate the impact of the public administration's activity by applying valid criteria for improving the quality of administrative services.

The new government also declared its intention to work actively towards upgrading public administration. This was supported by the establishment of dedicated Ministry of State Administration and Administrative Reform which has the ambition to draw up an abridged Civil Servant Code of Ethics. It will contain the 10

"golden rules" of civil servants' conduct. Other priorities of the Ministry include introducing e-government; and modernization and training of civil servants. Serious attention will be given to public-private partnerships, incl. in servicing businesses, which will undoubtedly serve to promote entrepreneurship.

## Public-Private Partnerships

BIBA representatives also recommend the establishment of public-private partnerships as a key focus of future efforts. The operation of the Council for Economic Growth is being quoted as a successful form of public-private partnership; it is seen as a "good" place for dialogue between the government, businesses and other non-governmental organizations.

There are specific examples of good practices in transforming dialogue into efficient public-private partnerships. A number of concession agreements on infrastructure projects have been a fine example of this over the past years. Another venue is the establishment of partnerships between businesses and Bulgarian universities. In 2005, an agreement was signed for the first time between BIBA and the Council of Rectors of Bulgarian universities. The purpose of that agreement is for university curricula and the number of students enrolled to be measured to the actual needs of businesses. This was an important first step towards tackling one of the major workforce issues in this country: the fact that the process of training and education is far removed from businesses' actual needs. The commitments made by BIBA representatives include: establishing a rating system for university at international standards – a process which will also involve business representatives to ensure greater objectivity of the criteria and evaluations, providing internship opportunities at leading companies to improve the students' qualifications and experience; providing students with access to the top managers of leading companies and institutions through lectures organized with BIBA support etc.

## Fight Against Corruption

In December 2005, the European Parliament voted on the reports of Bulgaria and Romania's progress to EU membership. The general spirit of the reports is that the two countries have made serious progress in many areas. The accession of Bulgaria and Romania to the EU without applying the safeguard clause is possible if the two countries succeed in meeting their pre-accession commitments. The accession date 1 January 2007 is fully achievable for Bulgaria, provided that actual results are in place. This applies, above all, to such key areas as justice, combating organized crime and *corruption*.

## Assessment of the Corruption Environment

As a whole, corruption is going up on a global scale - this is the conclusion of the specialized survey conducted by the international non-governmental organization "*Transparency International*", published in December, 2005, on the eve of the

<sup>21</sup> [http://www.aop.bg/page\\_id=343](http://www.aop.bg/page_id=343)



International Anti-Corruption Day. People from 48 of a total of 69 surveyed countries respond that corruption has increased over the past three years. According to most respondents, the most corruption exists in political parties, parliaments, the judicial system and the police.

Bulgaria is no exception from these global trends. The corruption situation in the country has deteriorated over the past year. The latest *Transparency International* survey registered Bulgaria's movement in the negative direction, although not very strongly pronounced. The document published by the organization in October 2005, "Corruption Perceptions Index"<sup>22</sup>, covering 159 countries, Bulgaria occupies the 55-th position at 4.0 index points. In 2004 the value for this index was 4.1, and the country occupied the 54-th position among 146 countries

In the *Report on Global Competitiveness 2005-2006* by the World Economic Forum published late in September 2005, Bulgaria was ranked 38th in corruption practices, which means a deteriorated position as compared to previous years (30-th position in the 2004 report). This is a clear signal from the business community on the severity of the corruption issue.

According to the *European Commission's Monitoring Report* of October 2005, the fight against corruption and organized crime is one of the areas of concern and requiring immediate action by Bulgaria.

Bulgaria should take serious action to reduce corruption in the judicial system by reviewing the current procedure for stripping magistrates of their immunity. Further effort is needed to provide an environment where public service will be more resistant to corruption, including preventive measures.

## Anti-corruption Measures

Anti-corruption efforts continued in 2005. Some changes were introduced in the regulatory framework in this area. Almost all legal instruments required by the *acquis* have been adopted. The new Political Parties Act adopted in March 2005, lays down a number of anti-corruption measures to guarantee the transparency and accountability in the financing of political parties, including a complete ban on anonymous donations, and better mechanisms for monitoring the activities of political parties.

The Act on Amendments to the Administrative Violations And Sanctions Act, laying down the responsibility of legal entities, was adopted in September 2005.

The application of the Act on Public Access to Information about the Property of Persons Occupying Senior Positions in Public Administration continues; it contains provisions on the establishment of a public register of declared property,

income and expenses of persons occupying senior positions in Bulgarian state administration.

Bulgaria also continued to implement the "Updated Action Plan for the National Anti-Corruption Strategy 2004-2005" through the Commission for the Coordination of the Fight against Corruption. However, the administrative capacity of this Commission remains weak. The Commission focuses above all on prevention and education measures, such as the development of special programs for education in anti-corruption practices at the Public Administration and European Integration Institute and in various high schools, and the implementation of specific programs for prevention in the different ministries and agencies.

In February 2005, the Council of Ministers adopted an important addition to the National Strategy against Corruption. It provides measures to combat high-level corruption. The amendment is aimed exclusively at undertaking measures to prevent corruption at the level of political cabinets and at curbing corruption in public procurement.

Bulgaria will need to continue the fight against high-level corruption. Bulgaria's current anti-corruption policy would greatly benefit from an independent audit which would contribute towards more efficient results in the fight against corruption.

The new government also declared that the fight against crime and corruption will be among its key priorities. Anti-corruption measures will increase in scope. At the end of 2005, the Commission for the Fight against Corruption adopted a legislative program which includes proposals for amendments to 6 laws.

The proposed changes aiming to prevent corruption refer to: the Privatization and Post-Privatization Control Act, the Criminal Code, the Tax Procedure Code, the Municipal Property Act, the State Property Act and the Public Procurement Act.

The proposals were discussed and coordinated jointly by government institutions and non-governmental organizations active in the area of the fight against corruption. The draft proposals include contributions from the Chief Prosecutor's Office, the Supreme Prosecutors Office of Cassation, the Commission of Enquiry on VAT fraud of the 39th National Assembly, the Bulgarian Industrial Association.

Amendments to these laws are expected to achieve tangible results in preventing some of the most widely spread corruption practices.

Taking into account the significance of this problem and the willingness to curb corruption practices, in early January 2006 the government adopted a Strategy on Transparent Governance and on Preventing and Combating of Corruption up to the Year

<sup>22</sup> [www.transparency.org/cpi/2005/2005.10.18.cpi.en.html](http://www.transparency.org/cpi/2005/2005.10.18.cpi.en.html)

2008<sup>23</sup>. The policy paper was drafted in co-operation with non-governmental organizations. They will also take part in monitoring the program implementation; the program however has not yet been finalized.

Two groups of anti-corruption measures are envisaged. One group is related to accountability and controls, and also to the transparent financing of politicians and ministers. The second set of measures aims to ensure transparency, accountability and financial control on parties' use of funds. Government efforts will be targeted at the prevention of political corruption and corruption in public administration. Priority areas will include the fight against corruption in public procurement, healthcare and education which were outlined as problematic areas by the European Commission.

The implementation of the Strategy will be coordinated by a Commission on the Prevention and Fight against Corruption which will be transferred from the Ministry of Justice to the Council of Ministers. The Chief Inspectorate Directorate under the Council of Ministers will serve as the Commission's Secretariat.

The Council of Ministers also approved the report on the implementation of the Strategy against corruption for 2004–2005. The best –performing institutions (about 80 per cent of planned measures) are the Ministry of Public Administration, the Ministry of Justice, the Ministry of Interior and the Ministry

<sup>23</sup> <http://www.government.bg/cgi-bin/e-cms/vis/vis.pl?s=001&p=0011&n=000129&g=>

*Developments in the public finance as of the end of 2005 are characterized by the persistence of major trends from the previous periods. These trends are reflected in Budget 2006. Among them, we can distinguish the increase of the real quota of reallocation through the budget, increased chronic budget surplus, and strengthening the role of the state in the Bulgarian economy. Changes made to the tax and social insurance laws did not result in reduced taxation and insurance burden, but rather in reallocation of the burden from direct to indirect taxes, which is quite positive itself, but does not constitute an incentive for the economic growth.*

### Budget Execution as of the End of November 2005

**Consolidated Budget<sup>24</sup>.** As of the end of November once again significant over-execution of the consolidated fiscal program was verified. According to figures presented by the Ministry of Finance, the *surplus* under this program reached the value of BGL 1 779.3 million.

Table 3. Budget surplus/deficit for the respective year  
(in million BGL)

	Date		
	30 November 2003	30 November 2004	30 November 2005
Amount	898.9	1 478	1 779.3

Source: Ministry of Finance, Budget Bulletin

Comparison of figures for the first eleven months of the three consecutive years shows a trend for increase in the budget deficit, which at the end of 2005 will get close to our forecasted surplus of about BGL 2 000 million. That is, in 2005 an excess of about BGL 2 000 million was collected from the taxpayers and transferred to the public authorities that however, was not provided for in the State Budget Act. If instead of being collected from the economy, this huge financial resource was used by taxpayers for consumption and investments, the economic growth in Bulgaria would have been much more intensive. While in 2003 the policy of circumventing the Budget Act was gaining momentum, in 2004 and particularly in 2005, it reached a climax. Under the “realized budget surplus” indicator, Bulgaria is the leader among the new EU members. It is obvious that the new Ministry of Finance, respectively the new government, will not only discontinue this practice, but most probably, will further extend it. Under the terms of agreement with the International Monetary Fund, budget surplus can not be spent and remains in the fiscal reserve.

As of the end of November, **revenues and aids** reached the amount of BGL 16 203.4 million, i.e. there was an increase of 13.3 per cent compared to these of November of the preceding

year. The good execution of budget revenues is due to the high collection rate of both tax and non-tax revenues.

During the same period **expenditures** registered an increase of 12.5 per cent compared to November of the preceding year and reached the amount of BGL 14 424.1 million. The largest relative share in the consolidated expenditures composition is attributed to the national budget<sup>25</sup> – 40.5 per cent, social insurance budgets – 34.5 per cent, and budgets of municipalities – 15.8 per cent.

Despite the announced application of the so called program budgeting approach, Budget 2005 does not match the intensive economic growth priority goal. Budget 2006 keeps the status quo of Budget 2005 which, basically may be seen as an advantage, considering the pre-election promises of the leading political power – the Bulgarian Socialist Party and the “agenda” of the coalition government.

**Fiscal Reserve<sup>26</sup>.** At the end of November the fiscal reserve reached the amount of BGL 5 322 million, keeping the trend of increase after the drop that came as a result of the buy-back of the foreign debt in July. Within the reserve, the accumulated deposit funds in the BNB amount to BGL 4 654.3 million, and the currency assets amount to BGL 2 098.3 million. Major omission in the governance of the former cabinet was the failure to set up a concept for use of the fiscal reserve. As of our knowledge, by now the new government has not yet submitted a motivated proposal for its use. From economic point of view the most efficient use of the fiscal reserve would be for reduction of the foreign debt.

In this period, there is a *surplus* of BGL 1 611.8 million in the **national budget**. The revenues and subsidies amount to BGL 10 604.7 million, whereas the expenditures and transfers amount to BGL 8 992.9 million. Revenues are mainly from taxes, whereas the expenditures come from overhead expenses, interest and salaries of the personnel. As of the end of November 2005, despite the net government transfers amounting to BGL 1 457.6 million, **budgets of municipalities** had a deficit of BGL 12.2 million.

In view of the key role of the national budget in the structure of the consolidated fiscal program, more detailed analysis of the revenues and expenditures is needed.

### National Budget Revenue

As of November 30, 2005 the national budget **tax revenues** amounted to BGL 8 806.2 million, which means 100 per cent execution of the estimates laid out in the National Budget Act.

<sup>24</sup> Consolidated budget includes the national budget and all autonomous budgets, i.e. those of municipalities, social insurance funds, state universities, Bulgarian Academy of Science, Bulgarian National Radio, Bulgarian National Television, Supreme Judicial Council, as well as the extra-budgetary funds and accounts on central and local levels.

<sup>25</sup> Composed of the central budget, budgets of ministries and other institutions, and the budget of the National Audit Office.

<sup>26</sup> Comprises funds in BGL and currency in all current and time deposits in BNB and commercial banks from the central budget, budget funds for ministries and institutions, National Insurance Institute, National Health Insurance Fund and their extra-budgetary accounts and funds, as well as other highly liquid and low-risk financial assets of the government in foreign currency.

The largest relative share in the tax revenues has the **VAT** – 40.7 per cent of the total revenues and 49 per cent of the tax revenues. At the end of August, an execution of 101.9 per cent compared to the Budget 2005 estimates was reported. The VAT collection rate is improving which is due to the following:

- increased import;
- increased control by the tax administration over the VAT collection;
- penal proceedings instituted for VAT-related tax fraud, such as VAT chains, ghost companies etc.

A major problem leading to circumvention of VAT payment is the slow tax credit refund. The lack of solution of this administrative problem together with the high VAT rate strongly affects the liquidity of companies. This raises the cost of export, import and domestic trade. Thus businesses either pay with very expensive working capital loans, or establish illegal trade chains avoiding VAT that are subsequently (“forced to”) avoid also the corporate taxes.

As of the end of November the **excise duty and charges** on liquid fuels have reached the amount of BGL 1 910.4 million. They have a high relative share of 18 per cent in the total revenues, and a share of 21.7 per cent of the tax revenues, where both relative shares have a slight increase compared to the previous quarter. An execution of 98.1 per cent on excise duties was reported.

As of November the relative share of the **personal income tax** in the total revenues is 10.5 per cent and 12.6 per cent in the tax revenues. The execution with respect to budget estimations is 91.4 per cent and its absolute amount have reached BGL 1 112.2 million.

**Corporate Tax.** For the reporting period the corporate tax revenues have a share of 8.3 per cent in the total revenues and 10 per cent of the tax revenues, where its absolute value has reached the amount of BGL 877.7 million. The corporate tax execution compared to budget estimates is 95.9 per cent.

**Customs Duties.** As of the end of November the revenues from customs duties and fees amount to BGL 335.7 million, which corresponds to 139.8 per cent execution and a share of 3.2 per cent from the total revenues. The considerable over-execution of budget estimates is due to the increased import as well as to the improved work of the customs administration.

**Dividend and Income Tax.** As of the end of November the revenues from this tax amount to BGL 77.2 million, where the over-execution is 127.1 per cent. This result clearly shows that the dividend tax shall be abolished as it does not result in financing through retaining of earnings, as its main economic function is.

As of the end of November 30, the **non-tax revenues** in the national budget have reached the amount of BGL 1 777.9 million, which is 109.3 per cent of the Budget 2005 estimates. The amount of the state fees collected shall be given special attention, since its execution is 154.2 per cent during the eleven-month period. It is obvious that if most of them get abolished, the budget, although being quite overestimated in these line items, will be over-executed anyway. The large number of fees and charges, alongside the bureaucracy and corruption, are a major obstacle to the business in Bulgaria.

### National Budget Expenditures

**Gross Expenditures.** At the end of November all expenditures made amount to BGL 5 840.4 million, compared to BGL 5 282.3 million for the same period of the preceding year, thus the growth is 10.4 per cent.

**Overhead Expenses.** As of November 30, the relative share of overheads in the total expenditures is 41.9 per cent or BGL 2 447.1 million. They include expenditures for medications, fuel, energy, hired services, current repair, as well as the cost of defense and security. The overhead costs made during this period represent 86.5 per cent of the estimated expenditures for 2005.

**Interest.** We refer to the interest paid on foreign and domestic loans that at the end of November amounted to BGL 654.6 million. (BGL 467.5 million – on foreign and BGL 187 million on domestic loans).

**Social Expenditures and Scholarships** amount to BGL 583 million, where the execution is 69.2 per cent compared to budget estimations.

**Subsidies.** With regard to subsidies there is a drop of 5 per cent compared to the same period of 2004. As of the end of November 2005 they amount to BGL 526 million which is 95.9 per cent of the budget estimations.

**Net Transfers.** The net transfers, i.e. the balance between the transfers made and received by the Republic of Bulgaria amount to BGL 3 152.5 million and represent an execution of 95.3 per cent.

### Domestic and Foreign Debt

**National Debt.** As of the end of November the nominal value of the national and the state-guaranteed debt amounts to EUR 7 051.6 million, which is by EUR 139.1 million more than it was at the end of August. The increase is due to new withdrawals and exchange rate fluctuations.



**Domestic Debt.** For the period from the end of August through the end of November the domestic debt has raised by EUR 24.9 million reaching the amount of EUR 1 453.8 million.

**Foreign Debt.** As of the end of November the foreign debt was EUR 5 597.7 million which is by EUR 114.1 million more than it was at the end of August.

**Debt/GDP.** As of the end of November the relation Debt/GDP is 33.4 per cent and is higher by 0.7 percentage points compared to the amount at the end of August.

While drafting the Budget 2005 announcement was made that it matches the main priorities of Bulgaria which are: (1) long-term economic growth; (2) decrease in the basic taxes; (3) increased income; (4) effective spending of the public sector budget, etc. In fact, these goals were partially achieved.

It is a fact that in 2005 the Bulgarian GDP has increased, but its growth rate is far below the one that can be actually achieved by the Bulgarian economy. There was a decrease in the income tax rate, but it was delayed and was too limited in size so as to adequately stimulate the economic and incomes growth. In contrast to the last budget of Ivan Kostov cabinet (Budget 2001), which reallocated 38.6 per cent of the gross national product, the last budget of Saxe Coburg Gotha cabinet (as per figures of the first nine months of 2005) reallocated 42.7 per cent of the GDP which was bigger than the one of 2001 by about 22 per cent. It is perfectly clear that the governance of the "liberal" alliance has significantly increased the role of the state in the Bulgarian economy.

If we look for results corresponding to expenses incurred in areas such as: healthcare, security and judiciary, defined as priority ones in Budget 2005, we will find out that the "cash" payment system is very popular in the healthcare sector, the outstanding structural and management problems are almost scandalous and the population's frustration is getting bigger, and the problems of judiciary and security are listed as the main obstacles on the road to the Bulgarian accession to EU. Out of these "priorities", there are no positive results in key areas such as education. Bulgarian infrastructure is still miserable which discourages foreign investments. The quality of services provided by the overstaffed public administration is still very low, notwithstanding the huge cost of its maintenance.

### Budget 2006

Contrary to the uneventful public finance management by the Coburg-Gotha cabinet and its priority focus on the foreign debt transactions (the effect of which is contestable), Stanishev cabinet came in resource-demanding times of disasters such as floods, drastic increase in the price of the oil, pressure for fast implementation of populist promises, unbridled credit

expansion. Let's add the inherited slow reforms including those relating to the structure of the tax system and administration.

As per the coalition partners' pre-election promises, Budget 2006 provides for a reallocation quota of 40 per cent of the GDP at balanced revenues and expenses. Under the pressure of the International Monetary Fund, a budget surplus of 3 per cent of the GDP is envisaged. I.e. the real expropriation through the budget will most probably surpass 43 per cent of the GDP; thus Bulgaria will be lined up with the European leaders.

The economic growth which is fundamental for the peoples' well-being is actually a hostage of the other priority goals of Budget 2006, i.e. "macroeconomic stability" and "social responsibility". In fact, this budget copies the previous one by going deeper into its negative trends such as the increase in the tax and security burden and the enlarged budget surplus. Despite that Budget 2006 strives for "reasonable fiscal policy", it is not clear what its equivalent in the economic policy of the ruling coalition will be. Only the desire to make Budget 2006 comply with the requirements of the International Monetary Fund and the European Commission is obvious, which is a fact that considering the pre-election promises, the government agenda as well as the government announcements in the economic and financial areas, shall be evaluated as positive.

In fact, the fiscal policy imposed by the Fund, is the policy of financial stability. If it really brings sustainable stability at a reasonable price, the Bulgarian economy and population will benefit from it. Since the galloping credit expansion of commercial banks can not be effectively curbed by the BNB, which, inter alia, appears as a growing negative balance in the current account of the balance of payments, the Fund is concerned for the future monetary stability in Bulgaria. As of present this stability is a fact, but due to the intensive growth of the broad money which does not correspond to the moderate GDP growth, there is a potential for development of a fast-growing inflation. The only contra-argument is that the National Statistical Institute does not register a significant rise in prices. But let's consider that their methodology has some restrictions and flaws and that in 1996 the NSI saved nobody from the devastating inflation. Since BNB is unable to curb the credit expansion and limit the credit growth into reasonable limits, the Fund is determined that through taxes the budget will collect the redundant funds from the economy. Thus the budget shall perform quasi-monetary functions. This performance of unusual roles is economically ineffective and its outcome is uncertain. On one hand the budget becomes a huge brake for the economic growth due to the compulsory high tax rates, and on the other hand, it can not effectively curb the credit expansion which is confirmed by the warnings of the Minister of Finance on the possible VAT increase. If this "extreme measure" gets enforced, Bulgaria will be the leader in the European statistics in terms of tax and social insurance burden, which will further discourage the foreign investors. For

Bulgarians the end result of the monetary burdened fiscal policy is a double loss: (1) real chance for inflation of their money and (2) overwhelming taxes. We shall not disregard the fact that the high tax and social insurance rates take the financial resource away from businesses and individuals, thus they are forced to borrow funds from banks. I.e., the implemented fiscal policy on one hand stimulates the credit expansion, and on the other, fights it.

The exit from this spiral will be to curb the credit expansion which may be achieved only through compulsory increase in the cost of BNB resource and significant raise in the obligatory reserve of commercial banks. Then the fisc will be "released" from the unusual monetary functions and the surplus accumulation as per the "reasonable" fiscal policy, shall be stopped. The best way to do it shall be through substantial reduction in the corporate and personal income tax.

The expensive credit resources do not stimulate the investment activity of companies, but if this monetary measure comes along with decrease or abolition of the corporate tax, which is unique opportunity for the fisc, private investments will not be discriminated but further stimulated. In addition, companies will operate for themselves on the first place, but not for banks' shareholders and clerks, as the current situation is. Much better option for the Bulgarian economy is to have strong capitalized companies and relatively weaker banks, rather than very rich banks and weak indebted companies.

Accumulation of budget surplus is a beloved practice of any government because it is an excellent opportunity for unsanctioned expenditure of public funds by party politicians and clerks. The practice proves that in the Bulgarian post-socialist environment this scenario works perfectly despite the recent restrictions of the International Monetary Fund. By the way, the IMF's policy becomes a comfortable screen behind which the government is unscrupulously overwhelming businesses and individuals with taxes. Another source of the sought uncontrolled expenditure is the fiscal reserve which somehow explains the lack of concept and legal framework for its use. Even though now the budget surplus is not available for spending and shall be directed to the fiscal reserve, at the beginning of each government's mandate this is not a problem because by the end of the mandate mechanisms for "unlocking" the reserve may be found which can certainly happen after the expiry of the agreement with the International Monetary Fund.

In order to increase the "social responsibility" in the Expenditures part of Budget 2006 provides for the following: increase in the salaries in the public sector by 6 per cent as of June 1, 2006; double increase of the monthly gross salaries of those working in the high school education by 4 per cent as of January 1 and by 6 per cent as of July 1, 2006, as well as pensions increase by 5 per cent as of January 1, 2006. In addition, expenditures of the population will marginally increase as a result of the

increase in the non-taxable minimum of the personal income tax from BGL 130 to BGL 180. It is not clear why the "social responsibility" shall be always measured in payments to be made by these who are economically effective to those who are not, rather than focus on the provision of quality and adequate public services.

Continuing the tradition of the double coalition National Movement Simeon II (NMSS)/Rights and Freedoms Movement (RFM), with Budget 2006 the triple coalition - Bulgarian Socialist Party (BSP)/NMSS/RFM increases the state role in the economy by increasing the real quota of reallocation through the budget, but also through the increase of public investments' share. The estimated capital expenses in Budget 2006 increase by 31 per cent compared to these from Budget 2005 and will reach the amount of BGL 2 200 million. The government hopes that the increased capital expenses will stimulate "economic growth". If these expenses are really more effective than the analogical expenses made by the private sector in fair market conditions, than they are adequate and we congratulate this measure. However, so far there are no arguments provided by the government, proving such a statement and we strongly insist on such arguments being given to the taxpayers. In the opposite case we can assume that the goal is to ensure "economic growth" of the chain of friends' companies in non-market conditions, rather than growth of the national economy which will most probably suffer significant net loss.

On the other hand, the company called Public Investment Projects which was established by the former government with BGL 340 million from the surplus for 2004 and strongly criticized by the International Monetary Fund will no longer get financed and will be closed down. In this contradictory situation it is impossible to understand the principal economic standpoint of the new government with regard to the role it attributes to the state in the Bulgarian economy.

### Tax Policy

The tax policy which shall accomplish the goals of Budget 2006, which are: "microeconomic stability", "sustainable economic growth", "preparation of Bulgaria for European Union membership" and "social responsibility increase", consists in reduction of the social insurance burden by about 6 per cent, increase in the indirect taxes, increase in the non-taxable minimum of the personal income tax, and raise of the real estates tax assessments.

For the economic players (especially potential foreign investors) is important to know in what the direction the tax policy in Bulgaria will develop, in order to consider it while making economic projections, plans and estimates. For them both tax rates and economic logic for definition of tax basis are important. How can the economic subjects identify the signals of the Bulgarian tax policy, when they lead to all possible economic directions?

The IMF Report on the Fiscal Transparency in Bulgaria affirms that the tax system is unstable and difficult to forecast, and tax payers are unequally treated. This finding is also applicable with regard to amendments made to the tax laws, enforced as of January 1, 2006.

As a result of the first tax reform of the new government there is no simplification of the tax system, although that when taking office the Minister of Finance and his team clearly promised so. We would remind that a simplified and logical tax system may be established only if based on clear economic principles, i.e. expert economic opinion, which is something that is obviously missing as grounds of the Bulgarian tax system. It changes under foreign institutional and lobbyist pressure following the principle "everybody will get something".

Following this "principle" and under the pressure of Bulgarian business organizations, the pension insurance burden was reduced by about 6 percentage points with the argument that its rate is too high compared to other Balkan and East European countries. According to the Ministry of Finance, this quite expensive measure will support the sustainable economic growth policy. Reduction of the high insurance burden is a step that we strongly support, but in the context of Bulgarian reforms it is premature and inadequate for the economic growth stimulation. It is largely known that the income tax is a factor strongly influencing investors' activity, especially when it comes to foreign investors. For them it is much cheaper to pay slightly higher pension insurance contributions on much lower Bulgarian salaries, rather than slightly lower social insurance contributions on quite higher salaries in other countries. Therefore, even with the old insurance rates, Bulgaria has some advantage in terms of the cost of labor. Any potential foreign investor in Bulgaria is more interested to know how much of the result of his capital and labor are to be shared with the Bulgarian state. This is of utmost importance for Bulgarian entrepreneurs.

Stimulation of the economic growth at first place and only by reducing the pension insurance burden is a Bulgarian "patent". Reduction of the insurance burden by about 6 percentage points corresponds to reduction of the profit tax by about 10 percentage points, i.e. if this necessary and economically more purposeful reduction have been made, on January 1, 2006 Bulgaria would have woken up with a profit tax of about 5 per cent – the lowest in Europe. The fact that at first place pension insurance and not the corporate tax was reduced is really amazing especially in view of the strong tax competition in the European Union that is taking place after the last historical enlargement. We now have to ask how Bulgaria is going to attract European investments in this very competitive environment. Is it through lower pension contributions? (Incidentally, the term "pension insurance competition" is not very popular in the European financial discussion).

From public finance point of view the reduction of social insurance burden as a main economic growth incentive is even less convincing. Let's remember that a very important step forward in the public finance reform in Bulgaria was the establishment of the National Insurance Institute and separation of the insurance system from the state. Due to the demographic situation, bad management and some problems of the insurance model itself, it is in deficit and is co-financed by the state budget. The plan is that in the future the insurance system shall be self-sustainable. With the insurance burden reduction the risk of considerable increase in transfers from the national budget is quite high, so rather than financial "separation" of the social insurance from the national budget, most probably the two will get tied in together. The truth is that each tying up leads to inefficient public funds management.

The pressure of the Bulgarian business for insurance burden reduction is fair and grounded, but financial policy turned out to be short-sighted and failed to satisfy this demand with priority. Much more purposeful for the price paid by public funds would have been the corporate tax reduction by 10 percentage points. Only after having achieved a positive influence over the economic growth, which would positively influence also the social insurance budget, its burden could have been reduced. There would be no risk of subsequent transfer of tax revenues from the national budget to the social insurance budget. This would be a step forward instead of being a serious risk of a step backwards in the public funds' reform.

Changes to the tax legislation that shift the tax burden from direct to indirect taxes, point into the right direction, but without reducing the burden itself, they are mostly reallocations and will not stimulate effectively the economic growth.

Collection of different taxes by different institutions without unified rules and common information system is on one hand prerequisite for weaker control and financial frauds, whereas on the other hand it is expensive due to overlapping of similar activities. In order to improve the efficiency and control on the tax collection, some five years ago the decision on establishment of the National Revenues Agency (NRA) to become operational as of January 1, 2006 was made. The reasons for delay of the NRA opening are due to the lack of administrative capacity of the former government to develop and get passed by the Parliament an acceptable bill of the Tax Insurance Procedure Code (TIPC). The other outstanding problem inherited from the former cabinet is that despite the generous support of the World Bank, the government failed to develop an unified information system.

The Tax Insurance Procedure Code became a fact on December 22, but the software is not ready yet. The NRA will have 28 regional directorates where the total number of employees will be 9 088 people. Pending are the repair works in the bulging of the "mega agency" that will cost EUR 35 million and are

expected to be completed by the end of 2007. The Executive Director and nine directors of regional NRA directorates were appointed by the end of December. Premises of the former tax authorities will become offices of the new Agency. Excise duties will be collected by the Customs Agency, whereas local taxes and charges will be collected by the local administration.

Together with the presentation of highlights of Budget 2006, the Minister of Finance announced that the Ministry is planning to reduce the corporate tax by 2-3 percentage points as of the next year, and that there will be new Corporate Tax Act and VAT Act. These positive signals to the businesses will in no way compensate the weaknesses of Budget 2006 along with the signals for possible VAT increase. The VAT collection is quite inefficient thus businesses incur significant financial losses.

The fiscal policy shall be definitely released from its quasi-monetary functions and temptations relating to the possible accumulation of budget surplus by freeing the Bulgarian economy from taxes and insurance contributions. Economically, the most adequate way to do this shall be through a considerable reduction (or abolishment) of the corporate tax firstly, and subsequently followed by the personal income tax and the social insurance burden.



*The situation on the labor market is marked with positive changes and expectations for improvement as a result of the policy implemented. Its aims are realistic and its instruments, as in previous years, include programs and measures for subsidized employment. What presents a novelty is the focusing on the improvement of the adaptability of the workforce through making it literate, providing education and re-qualification. The income and the living standard of the population are moderately increasing, but so is the pessimism of the consumers, as well as the financial pressure over households because of indebtedness. The government started new programs for social support to guarantee the education of children from low-income families and is setting ambitious goals in the area of demographic policy. The social insurance burden for 2006 is lowered by 6 points but the effect of this change is rather re-distributory than actually improving the conditions for doing business. A Silver investment fund should be created by the end of 2006 to guarantee the financial sustainability of the pension system. This is the beginning of a promising new form of re-distribution of demographic risk. The key problem of the health reform in 2005 was related to the financing of the hospitals. As from 2006 the National Health Insurance Fund (NHIF) shall be the sole source of finances and the government program provides for the optimizing, restructuring and privatization of the hospital facilities.*

## Labor Market Policy

**Legislative Amendments.** The last months of 2005 confirmed the solid tendency, which began in February, for decrease of the unemployment rate and its nearing the levels in Europe. Expectations are that the positive changes on the labor market continue also under the influence of the amendments and supplements in the Act for the Encouragement of Employment and the rules for its implementation, adopted in November. The aim of the amendments is to optimize the activity of the territorial units of the Employment Agency and the limitation of administrative hurdles, faced by the unemployed and the employers, using programs and measures for employment and education. The amendments in the legislative framework will stimulate the personal initiative and responsibility of the unemployed to seek jobs and provide additional funds for them, if they find new jobs themselves. In order to stimulate their entrepreneur activity, the budget shall cover their expenses for consultancy and other services for starting an independent business.

**The need for Education and Re-qualification.** This last 2005 marked the existence of stable and deepening structural inconsistency on the labor market with regard to education and qualification levels of the workforce. Given the stable and high economic growth, the inconsistency is even more obvious and the prospects are very alarming. According to the specialized report on the education in Bulgaria, drafted by the Economic and Social Council, in 2005 one fifth of the young people

between 18 and 24 years of age have not completed their high school education and only 17% of the workers have technical qualification and specialty. For the sake of comparison, the relative share of this group of workers in Western Europe is approximately 30 %. More and more often companies face difficulties in recruiting suitable personnel, when they expand and restructure their business activity, due to the ever decreasing quality of the high school and university education in Bulgaria. Vocational training suffers from the outworn material conditions and programs in schools, there is no relation to practice and specialized language training is underestimated. Neither does university education conform to the needs of the labor market. On this background it is even more alarming that Bulgarians do not have any experience, traditions or inclination towards "life long learning" and the acquiring of new qualifications and professions.

**Prospects for 2006.** The 2006 priority should be the measures for the improvement of the adaptability of the workforce, for which approximately 30 million BGN have been allocated in the budget. Most of the money will be used for education, qualification and literacy courses for the unemployed. The education programs include qualification courses for professions employers are mostly interested in. Besides that, pursuant to the National Employment Plan for 2006, the employment programs and measures shall cover as priority the young, the long-term unemployed, persons in pre-retirement age and disabled individuals. Those will be financed by approximately 200 million BGN from the budget. In 2006, a number of specialized programs for subsidized employment, which started in the last few years, will continue their implementation. It is a positive development that the *From Social Welfare to Employment* Program will be applied in a limited version, while employers' participation will be actively solicited for the subsidized employment programs. The successful cooperation between the Ministry of Labor and Social Policy and the employers opens opportunities for the jobs, created under preferential conditions, to stabilize and guarantee sustainable employment for the unemployed.

The program of the government in the field of the labor market is realistic. Its goal is to create conditions for the opening of 240 000 new jobs and overcoming of regional discrepancies so that unemployment could be stably decreased to levels under 10 percent. The novelties include the determination of the government to encourage different forms of employment and organization of working time and to increase the flexibility on the labor market. The program shows a clear understanding of the relation between creating jobs, encouragement of investment activity and stimulation of small and medium enterprises.

## Income and Standard of Living

**Income Dynamics.** This last 2005 will most probably be remembered by a moderate increase in the income of Bulgarians, comparable to previous years. This is shown by the



data on the real salary and real income of the households in the last quarter of 2005, compared to the same period in 2004. In the meantime, public attention was actively and continuously concentrated upon the expectations for a raise in the income in 2006, especially given the pre-election promises of the Bulgarian Socialist Party (BSP), the teachers' strikes and the adoption of the budget.

Official statements of government ministers claim that next year's increase in the income is expected to reach 10 percent, given the raise in the pensions with 5 percent as from 1 January, the increase in the salaries of civil servants with 6 percent as from 1 July, the increase of some social payments, the decrease of the social insurance burden and the amendments in the taxation of physical persons' income. On the background of the expectations, however, even this increase could prove very insufficient. Expectations co-exist with the predominantly pessimistic attitude of consumers and the fall in their confidence during most of 2005, registered by the latest survey of the National Statistics Institute (NSI). The survey shows that the financial situation of the households during the last year has deteriorated and a continuing negative trend is expected for the next 12 months. Pessimism is fostered especially by consumers' expectation of a raise in inflation. The increasing financial pressure over households, measured as correlation between the credits of the physical persons and their savings and income, is also a factor of influence.

**The Policy of the Government for Improvement in the Living Standard.** The comparison of the intentions of the government for the period between its entry into office and the adoption of its program shows a clear will for specifying the aims and the instruments of its income policy and more realism, while keeping at the same time the social impetus in the government of the tripartite coalition. This impetus is shown mostly by the decision to increase on an annual basis the minimum monthly salary in accordance with the official line of poverty. The government expects to influence indirectly the labor income on a national scale, relying on collective labor agreements in specific spheres and companies. For the first time this government is committed to introducing minimum hourly wages and more flexible forms of payment through amendments in the labor and social insurance legislation.

## Social Welfare and Demographic Policy

**The Struggle against Poverty and Social Isolation.** The new program of the MLSP *Social Investment in Children* for covering kindergarten fees, canteen food in schools, books and study aids for children of families on social welfare, saw further development. The social-liberal government thus intends to support low-income families with children and guarantee their education and social integration, so that children do not end up in the vicious circle of poverty. The government has also the ambition to work for the effective distribution of social welfare

towards the groups having lowest income and subject to highest risk and apply a diversified approach in the assistance to persons of most serious situation. Those programmatic intentions sound justified and suggest willingness for a change and development of current policy in this area, they just need to be fully legislatively and institutionally supported.

The plans for limiting the negative consequences of the demographic crisis, using the methods of social policy and including in it for the first time in the transition period elements of demographic policy, are also very ambitious. The problems of low birth rate, high mortality rate, reproduction and ageing of the population are undoubtedly grave and require complex state policy, which, however, should encompass a number of long-term reforms and measures, which exceed the scope of social policy. This government intends within the time of its tenure to fully introduce family income taxation and stimulation through various measures of the birth and upbringing of two children per family. Expectations are that this policy would have a certain positive effect, but if it is not part of a long-term and complex demographic policy, the effect will be largely limited.

## Social Insurance

**Main Legislative Amendments and Initiatives.** The expected implementation of the budget of the state social insurance for 2005 is 103.3 percent of the planned insurance payments of employers and 104.5 percent of the planned insurance payments of self-insuring persons. In the expense part, there is 0.4 percent over-expenditure of pension funds.

The key amendments in the revenue part of the budget for 2006 are: the decrease of the insurance payment towards the Pensions Fund with 6 points from 29 to 23 percent, the increase of the payment towards the Universal Pension Fund for persons, born after 1959, from 3 to 4 percent and the change in the proportion of employers' and employees' payments from 70:30 to 65:35. The decrease of the insurance burden is estimated around 630 million BGN, which will be compensated by a budget subsidy to the Pensions Fund. The overall amount of the deficit of the National Social Insurance Institute (NSII) will reach 1.5 billion BGN (almost one third of the expenditures) and will create certain risks for the solidarity and transparency of the management of the insurance system – principles, based on which the 1999 pension reform was done. The decrease of the insurance burden would have a most positive effect, if the 630 million BGN "saved" are spent on investment in new jobs, new technologies and improvement of competitiveness. Employers, however, expect a substantial raise of other expenditures, related to the price of fuels, the implementation of EU ecologic standards, etc. In the meantime trade unions insist on a raise in salaries to compensate the increase in the relative share of payments for the employees. As a consequence, the effect of the amendments is rather re-distribution (distribution of the

burden on the relatively wider fiscal basis of the state budget) than actual decrease of the fiscal burden on businesses.

In 2006 the number of insured persons is expected to rise by over 114 thousand people, compared to 2005. These expectations relate to the elasticity of the labor market, as well as to the raise in the collection among self-insuring persons and agricultural producers. The new insurance thresholds negotiated raise the average insurance income with 8.17 percent, compared to 2005. The insurance basis is rising also because of the higher limit of monthly insurance income – from 1300 BGN in 2005 to 1400 BGN in 2006. The general positive effect of those parameters during the next year is expected to bring around 220 million BGN of additional revenue in the budget of the state social insurance.

Table 4. State Social Insurance Revenue (in thousands of BGN)

	Budget 2005	Expected implementation 2005	Budget 2006
Total revenue, including:	3 388 336	3 448 274	3 048 680
Employers' payments	2 249 351	2 324 324	1 923 644
Personal payments of employees	775 750	790 410	823 919
Payments of self-insuring persons	158 405	165 524	133 352
Principals and interests of inspection acts	193 273	144 113	148 069

Source: National Social Insurance Institute

**Pensions.** According to preliminary data, in 2005 the pension expenditures have been 3 676 million BGN. The number of pensioners during this last year was 2 315 521 and the average number of pensions was 2 767 490. Pensioners are down by 12 thousand compared to the previous year and the ones with disability pensions increased by 58 thousand. Experts claim that the reason for the rapid increase of disability pensions is the frequent abuse of the work capacity expertise. Thus the restrictive criteria for granting length of service and age pensions are bypassed. With regard to this problem in 2005 the NSII appointed trusted doctors in the doctors' expert committees and introduced additional control through special committees for confirming the decisions on working capacity lost.

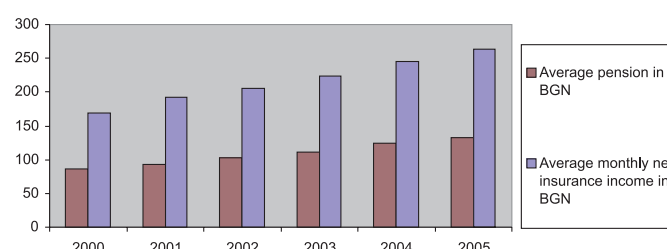
In June 2005 pensions were updated by a ratio of 1.07. The average monthly pension reached the amount of 133 BGN, which is nominally 9.8 percent more than 2004 and the actual increase is 5 percent. Preliminary data show a certain decrease in the replacement rate of pension income, calculated as a correlation between the average pension and the average monthly net insurance income for the relevant period. This is partly due to the larger share of disability pensions, which have relatively lower amounts. The replacement rate depends also on the indexing of pensions. Until 2005 Bulgaria applied a modified version of the so called Swiss formula, in which the index of

consumer prices had a share of 75 percent and the index of increase of insurance income had 25 percent. The government program for 2006 provides for a new approach for indexing of pensions. The main changes in the methodology, introduced by the Act on the Budget of the State Social Insurance, are the increase of the share of the insurance income factor to 50 percent and the update of pensions at the beginning and not in the middle of the year. Those changes are supposed to limit the "margin" between the pensions and the insurance income.

The matrix of government measures includes also the development of a new mechanism for the calculation of non work-related pensions, including the social pensions for disability and age. This is still to be done in 2006. On one side, the mechanism should adapt social pensions to the dynamics of average income and guarantee the living standard of beneficiaries. On the other side, it should also take into account the fact that the social pension for age is used as a measurement of the minimum level of the other pensions.

**Financing of Deficit.** The four-year program of the government provides for the creation until the end of 2006 of a Silver Investment Fund for supporting the balance and increasing of financial sustainability of the pension system. This idea is implemented by the Act on State Budget for 2006. The fund will accumulate at a minimum 25 percent of privatization revenue and 50 percent of the economized expenditures of budgetary organizations. The fund's profit will accumulate at the NSII as an alternative budget source of revenue. The silver fund will not be apart of budget, but will constitute part of the fiscal reserve. Although this source will at first cover a relatively small part of the overall deficit of state social insurance, it marks the start of a promising method for re-distribution of demographic risk, applied in a number of European countries.

Graphics 18. Replacement Rate of Pension Income (2000-2005)



Source: National Insurance Institute

## Supplementary Pension Insurance

Throughout the whole 2005 there was a stable tendency of increase in the assets of pension funds and in the number of persons insured. At the end of the year the relative share of the assets in the Gross Domestic Product exceeded the limit of 2 percent. The key factor of these positive dynamics has

been the increase in the number of participants in the Universal Pension Fund, which includes younger, economically active persons. Pursuant to the steps, listed in the Social Insurance Code, in 2006 the insurance payment for the universal funds for supplementary mandatory pension insurance shall increase from 3 to 4 percent, which is to accelerate further the accumulation of assets to rise 4 times by 2010.

A good example of partnership is the advertising campaign for the supplementary voluntary pension insurance, which began in October, initiated by Doverie Pension Insurance Company. The campaign is informative and its aim is to stimulate the demand of this product among the economically active citizens. The stabilization of the financial system leads to a tendency of long-term planning of personal investments. In 2005 7 percent of the households' assets were invested in pension funds, life insurance companies and mutual funds, while in 2000 the share of those investments was 2.5 percent. A diverse group of clients is already seeking for forms for profitable and secure long-term saving of the extra funds. Businesses also understand its importance for motivating their personnel and improvement of labor relations. Employers, who make payments for supplementary voluntary pension insurance, are already not only foreign investors. In the last few years a growing number of Bulgarian employers apply that model of company social policy.

**Insured Persons.** The reports of the Social Insurance Supervision Directorate of the Financial Supervision Commission show almost 7 percent rise in the number of insured persons, who amount to over 2.9 million people at the end of September, 2005. Clients of universal pension funds show the fastest increase, which also raises their share in the overall structure of pension funds. Toward the end of the year they amount to three quarters of all insured persons. The overall tendency of the scope of the supplementary voluntary funds can also be estimated as positive. After the initial fall in the number of insured persons during the first months of 2005 a stable tendency for increase started. According to latest data, 543 thousand people were insured in them, which is by 7 thousand more than in 2004.

**Pension Assets.** At the end of the first nine months of 2005 the actual net assets of the pension funds exceeded 1 billion BGN, which was their expected amount for the end of 2005. The overall increase of the assets of 29.4 percent is 4 times higher than the increase of the insured persons, which is an indicator for the profitability reached. An 18.5 percent increase in the assets and 1 percent increase in the number of insured persons are reported for the first nine months in the supplementary voluntary funds.

**Investments.** In 2005 no substantial diversification was seen in the investment portfolios of pension funds. Their structure could be seen as conservative. Over half of the assets of the

universal and occupational funds are still in state securities (56 and 57 percent respectively). An apparent change is registered only with the voluntary funds where the share of securities, issued or guaranteed by the state, decreased to 46 percent to the benefit of relatively more profitable financial instruments (a slight rise in the stocks and bank deposits).

In 2005, as well as during the previous year, the mandatory pension insurance funds did not benefit from the relatively liberalized investment regime in the Social Insurance Code. Their investments in bank deposits are around 7 points under the maximum and the relative share of stocks and corporate bonds is twice below the limits.

Bank deposits are the second significant financial instrument, having over 18 percent in the portfolio of universal and occupational funds and 23.6 percent in voluntary funds. The overall amount of deposits in pension funds is around 180 million BGN.

The share of investments in stocks and corporate bonds is 15 percent for universal pension funds and under 14 percent for the rest. The amount of investments in those financial instruments is only 140 million BGN at the end of the first nine months of the year. This is around 9 percent of the overall traded volumes on the regulated securities market for the same period. Comparison shows that pension funds still stand far from their role of major investor and development factor for Bulgarian business.

In 2005 investments abroad remained under 1 percent of all funds. Despite the increase of the limits for investment in foreign securities (15 percent for the mandatory pension insurance funds and 20 percent for voluntary funds) this financial instrument remains underused. This is due to internal reasons (investment strategies of pension funds not being sufficiently active), as well as external ones – limitations in the supply of high-income and attractive securities on foreign markets.

**Profitability.** In 2005 profitability indicators of pension funds (calculated and weighted average on annual basis for the last 24 months) remained on levels over 10 percent and stayed much higher than inflation and the average interest on BGN deposits. Annual weighted average profitability of universal and occupational funds at the end of the year is 10.8 percent, the minimum profitability being, respectively, 6.49 and 6.48 percent. Average annual profitability of occupational funds is slightly lower (10.48 percent), although they have more freedom in choosing their financial instruments.

**Concentration on Pension Market.** The high degree of concentration did not change in 2005 and this is a logical consequence of the limited scope of Bulgarian pension market and the very similar structure of funds' investment portfolios. Around two thirds of the market share is concentrated into

the two biggest pension insurance companies – Doverie and Allianz-Bulgaria JSCo.

Allianz – Bulgaria Pension Insurance Company (PIC) is the market leader with regard to net assets – 35 percent. Doverie PIC follows closely with its 33 percent.

Doverie PIC has the biggest share of insured persons for the first nine months of the year – 38 percent. Compared to the end of 2004, the share has diminished by over 1 point. The fall reflects mainly on the universal pension fund of the company, although it has biggest average monthly profitability and this indicator should influence the individual choice of new clients, as well as the methodology for *ex officio* distribution of persons, who have not chosen a pension fund. The low marketing activity of most pension insurance companies does not help the re-distribution of the market.

The data the Financial Supervision Commission has shown decrease in the mobility of clients after the first half of 2005, when the requirement for a notarized signature on the application for changing pension funds entered into force. This measure was introduced to guarantee the will of the insured persons and to prevent misuse, but it actually complicates the procedure and many people give up changing their fund. The third quarter of 2005 showed around 82 percent fall in the number of insured persons, who changed their pension fund, compared to the second quarter of the year.

Despite the general tendency of accelerated capitalization and expanding scope of persons in the supplementary pension insurance, this last year marked a number of problems in the investment activity. The government-drafted amendments to the Social Insurance Code provide for liberalization of the investment regime of the mandatory pension insurance funds – the minimum investment thresholds for state securities are revoked and the thresholds for investment in more profitable instruments are raised by 5-10 points. However, the cautious investment attitude of pension funds could continue even with a more liberal legislative framework, especially if not significant changes on the capital market occur.

Those tendencies confirm the need for strengthening the positions of pension funds on the capital market. The government program provides for the “development of economic stimulation for strengthening the role of the second and third pillar”. This general formula should be specified not so much by special privileges, creating risks for the competition on the capital market, but rather by clear and predictable rules for the tax and administrative environment and institutional development of the second and third pillar.

One of the important measures of the government program to be implemented in 2006 is the harmonization of supplementary pension insurance with the requirements

of EU law. Within European context supplementary pension schemes are mainly built on an occupational basis and correspond to the third pillar in Bulgarian pension model. The transfer of EU directive 98/49 involves amendments in Bulgarian legislation to allow participants in supplementary pension schemes to keep their rights while passing from one Member State to another.

Table 5. Dynamics of Insured Persons

	As to 31 December 2004	As to 30 September 2005	Change 30 Sept 2005/ 31 December 2004 in %	Share of insured persons by funds as to 30 September 2005
Number of insured persons in supplementary pension insurance funds	2716367	2905344	6.95	100.0
Number of insured persons in universal pension funds	2004776	2182691	8.87	75.13
Number of insured persons in occupational pension funds	176175	179684	1.42	6.18
Number of insured persons in voluntary pension funds	535416	542969	1.41	18.69

Source: Financial Supervision Commission, Insurance Supervision Directorate and own estimates

Table 6. Net Assets Available (in thousands of BGN)

	As to 31 December 2004	As to 30 September 2005	Change 30 Sept 2005/ 31 December 2004 in %	Share of net assets by funds as to 30 September 2005
Net assets in supplementary pension insurance funds	787414	1019085	29.42	100.0
Net assets in universal pension funds	261125	393184	50.57	38.59
Net assets in occupational pension funds	20083	240136	19.57	23.56
Net assets in voluntary pension funds	325457	385765	18.53	37.85

Source: Financial Supervision Commission, Insurance Supervision Directorate and own estimates



Table 7. Structure of the Investment Portfolio of pension funds as to 30 September 2005 (in % of all investments)

No	Investment Instruments	Universal PF	Vocational PF	Voluntary PF
1.	Securities, issued or guaranteed by the state	56.28	57.14	46.56
2.	Securities, accepted for trading on regulated security markets	15.08	13.81	13.72
2.1.	Stocks	6.34	5.62	5.74
2.2.	Corporate Bonds	8.74	8.19	7.97
3.	Municipal Bonds	0.65	0.79	0.51
4.	Mortgage Bonds	8.80	8.37	11.48
5.	Investments abroad	0.65	0.39	0.70
6.	Securities' Derivatives	0.00	0.00	0.00
7.	Bank Deposits	18.02	18.72	23.61
8.	Investment Properties	0.53	0.78	3.43
	<b>Investments total</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: Financial Supervision Commission, Insurance Supervision Directorate

Hospital and St. George Plovdiv University Hospital and others having around 15-20 million BGN of debts. Administrative measures were taken for changes in the management of the hospitals, but apparently they cannot overcome the financial collapse in the sphere of hospital care.

The two parallel sources of financing of hospitals – NHIF and MH – are stated by the government as the main obstacle for effective control. In 2006 the NHIF will be the only source of financing. For this, 815 million BGN are allocated in its budget for hospital care, which is 15 percent more than the sum for 2005. The number of clinical paths in the framework contract for 2006 increases from 120 to 299 and the average amount for a clinical avenue is raised from 525 to 549 BGN.

Table 8. Market Share of PIC's

Pension Insurance Companies	Market share in %					
	Number of insured persons			Net assets		
	As to 31 December 2004	As to 30 September 2005	Change	As to 31 December 2004	As to 30 September 2005	Change
Doverie PIC JSCo	39.09	37.97	-1.12	33.18	32.92	-0.26
Saglasie PIC JSCo	10.92	11.10	0.18	9.71	9.72	0.00
DSK-Rodina PIC JSCo	6.60	6.89	0.29	5.25	5.54	0.29
Allianz-Bulgaria PIC JSCo	25.61	25.75	0.14	35.51	35.01	-0.51
ING PIC JSCo	8.29	8.30	0.01	7.62	7.96	0.34
CCB – Sila PIC JSCo	4.06	4.17	0.11	2.06	2.16	0.10
Lukoil Garant – Bulgaria PIC JSCo	4.33	4.28	-0.05	6.29	5.99	-0.29
DZI – Pension Insurance JSCo	1.10	1.54	0.44	0.38	0.71	0.33
Total	100.00	100.00	0.00	100.00	100.00	0.00

Source: Financial Supervision Commission, Insurance Supervision Directorate and own estimates

## Healthcare Reform

**Hospital Care.** In 2005 the key problem before health reform was related to the financing of hospitals. In December, 2005 the budget of the NHIF was updated and the hospital expenses were raised from 295 million BGN to 375 million BGN due to higher collection and increased revenue from insurance payments. Thus the share of hospital care increased from 34 to almost 40 percent of all the expenses of the NHIF, but the financial resources available were not sufficient for implementation of the activities under the clinical paths approved. According to medical specialists the prices, negotiated for most clinical paths, cover only two thirds of their actual value.

The accumulation of unpaid debts of hospitals has become a chronic problem since 2002. Towards the end of the year the overall indebtedness reached over 200 million BGN. The inspection, which the Ministry of Health (MH) did in the autumn of 2005, showed that the largest elite hospitals had biggest debts, including St. Ekaterina University Hospital, National Cardilogic

The introduction of the method of diagnostically related groups is perceived by experts as a more realistic instrument for pricing medical activities, compared to clinical paths. In order for the method to be introduced, however, integrated information system is needed in the health care sector, which is still in process of development.

The control, which will be exercised by the NHIF, will most probably be insufficient for effective regulation of the expenditures in hospital care, because, in contrast to pre-hospital care, there is no real competitive environment in this sector. The overall number of hospitals in the country is 300, but the ten largest hospitals have received 20 percent of the persons hospitalized in 2005. The closing of ineffective hospitals is apparently a pre-requisite for adequate financing. That is why the government's program provides for optimizing, restructuring and privatization of hospitals as one of its main priorities.

**Medicine Supply.** The increase in the prices of medicines and the overspending of funds for this item in the budget of the NHIF was also much discussed in 2005. For solving this problem,

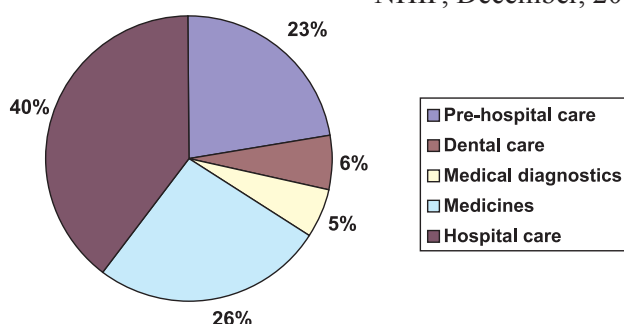


the government proposes that the NHIF organize bids for all fully and partially covered medicines for home use (over 900 in number) under the Procurement Act. The aim is to guarantee a more transparent and reliable procedure for supplies, compared to the current one. The amendments are also related to the EU requirements to the implementation of the Procurement Act. The inclusion of the NHIF in its scope will require a negotiation of the quantities of medicines, as well as their prices. This will create a risk for incorrect planning. The previous practice of the MH for supplying the medicines for socially significant illnesses (cancer, AIDS, hemophilia, etc.) often provoked insufficiency crises and the procedure under the Procurement Act takes months and does not allow for the flexibility needed. Bidding procedures should adapt to the specifics of the health sector so that they can achieve the economic effect and transparency sought.

**Persons Having Health Insurance.** Despite the number of measures for increasing the collection of health insurance payments, including online control by the general practitioners, options for delayed payments to be paid in installments, etc., there are still 1.1 million citizens with suspended health insurance rights at the end of the year. Half of them reside abroad. The amendments in the Health Insurance Act relieved those citizens from accumulating new debts after the beginning of 2005. Persons employed in agriculture seem like the group of highest risk. Only 10 percent of them are under health insurance, although their insurance regime is preferential and they pay twice as lower minimum as the one paid by the other categories of self-employed.

For solving this problem, the government's program provides for cataloging the persons with suspended health insurance rights as soon as possible and for measures to be taken for a fair solution to their problems.

Graphics 19. Structure of the updated budget of the NHIF, December, 2005



**Voluntary Health Insurance.** Despite a good legislative basis since 1998, voluntary health insurance still takes a minimal share on the market of health services. At the end of October 2005 the income of the twelve licensed companies is 15 million BGN and the compensations paid amount to 6 million BGN. Until the end of the year income from premiums is expected to reach 20 million BGN – a sum, constituting the budget of a

medium-size hospital. The reasons for the limited development of the sector are mainly related to demand (relatively low income of population, lack of insurance traditions, and low limit of non-taxable social expenditures of employers until 2005). The supply of health services also induces negative factors. The contracts between health units and companies for voluntary health insurance are not concluded in a normal competitive environment, because the scope of medical services is limited, the prices are not regulated and there are no mechanisms for quality control.

The most alarming consequence of the limited market of supplementary health insurance is the mass practice of unregulated payments of health services. All patients, for whom referrals for medical specialists and analyses are not sufficient, are forced to pay for them directly. This source of income for the health care units exceeds many times their revenue from voluntary health insurance. Services, requiring individual payments, not only burden household budgets, but also create additional social risks, because specialized quality control is concentrated mainly upon the activities, financed by the NHIF.

The tendencies in the social policy for 2005 correspond to the key aims to increase the competitiveness on Bulgarian labor market, to apply EU requirements, related to free movement of persons and the meeting of economic and political criteria for membership. Those tendencies at the same time allow for the development of specific legislative and administrative measures to implement social priorities, set in the four-year program of the coalition government. More active measures and determination are needed, however, especially in the health care reform, re-qualification of long-term unemployed persons and the development and implementation of demographic policy.

*New steps were taken in the past year towards the integrated management of natural resources and their use in compliance with the principles of sustainable development and environmentally responsible behavior by businesses and consumers. 2005 was the first year after the closing of negotiations with the European Union on the Environment Chapter; environmental protection and achieving compliance with the environmental criteria became a challenge to the managerial, administrative and expert potential of government institutions. As a result of the level of legislative harmonization achieved, the top priority of public administration in the past months was to meet as quickly and completely as possible the European Commission's requirements on compliance with the EU directives governing the sector. Within the strict framework provided by the pre-accession commitments, our country established a number of national schemes to achieve the targets of environmental protection.*

## 1. Integration of Bulgaria into the European Union's Environmental Policy

### 1.1. Environmental Legislation and Compliance with the *Acquis*

In 2005, the European Commission's opinion contained in the Monitoring Report of October confirmed the country's achievements in transposing the environmental *acquis* and the implementing the key policy principles: polluter pays, fighting environmental damage at source and shared responsibility.

The positive conclusions on the transposition of environmental legislation were accompanied by some criticism on its implementation. According to the Commission's report, the following are imperative for the successful enforcement of the environmental laws: better qualification of the administrators at the regional and local level, the coordination between institutions (MEW, MH, ME, MAF), environmental organizations and civil participation in the implementation of municipal and national plans and programs. According the Commission report, the guarantees to citizens' and their representations rights of access to information and justice on environmental matters in another positive factor in the country's preparation for EU membership.

The Commission's Report also underlines some specific problems in the following areas:

- water quality - measures are needed to improve the the drinking water network and the monitoring system at regional level for drinking water;
- industrial pollution and risk management – no national emission ceilings are in place;
- chemicals and GMOs – the adoption of the Code of Good Practice on nitrates is delayed, as well as the adoption of

an inventory of manure storage capacities and adoption of a permit regime for GMOs;

- nuclear safety and radiation protection - legislation concerning the shipment of radioactive waste and medical exposure has yet to be adopted.;
- waste management - no legislation is in place on polychlorinated biphenyls, polychlorinated terphenyls, waste oils and batteries.

The Commission positively assessed Bulgaria's achievements on environmental noise protection.

### 1.2. Environmental Policies

In 2005, the Council of Ministers prepared and adopted a new National Environmental Strategy for 2005-2014. The Strategy puts together a large volume of information on the condition of the sector up to the year 2005 and sets out six strategic objectives:

- ensure a good quality and sufficient quantity of water for all purposes;
- achieving and maintaining a high quality of the environment in urban areas;
- conservation of the natural heritage and maintaining rich biodiversity;
- integration of environmental policy into development policies for economic sectors and regions;
- ensuring the efficient environmental management;
- meeting Bulgaria's commitments towards addressing global environmental issues.

The Fundamental concepts underlying the National Strategy were the stepping stones that helped establish the priorities of the Operational Program Environment for 2007-2013.

Together with the National Strategy on Environment, a National Action Plan for 2005-2009 was also adopted in 2005. The plan contains well-tested methods to achieve the targets set out in the National Strategy. It envisages "risks measures" like: a change in the way environmental activities are financed, integrating environmental approaches in public procurement procedures, introducing incentives for environmentally responsible conduct by manufacturers and consumers etc.

#### 1.2.1. Protection of Natural Resources and Bio-diversity

Bulgaria has been making substantial effort to preserve its natural endowments and biodiversity. NSI figures show that protected territories in 2004 covered 544,395 hectares ([www.nsi.bg](http://www.nsi.bg) – November 2005) or 4.9 per cent of the country's territory. By the end of, 2005 standard plans and maps were prepared for 581 potential sites under the European Program Natura 2000. Expectations are that as a result of the application of European directives in the area of bio-diversity, protected

territories in Bulgaria may reach up to 7.5 per cent of the country's territory. To comparison, the planned increase in the percentage of protected areas to the total area of the country as a result of the implementation of European policies, is as follows: for Slovenia from 6 per cent to 32 per cent, for Malta from 18 per cent to 28 per cent, for Lithuania from 11 per cent to 19 per cent, for Estonia from 16 per cent to 18 per cent.

## 1.2.2. Industrial Pollution Prevention

In implementation of the European Directive concerning integrated pollution prevention and control, 76 integrated permits were issued in 2005 from a total of 289 plants in energy, metallurgy and chemical industry that should be issued with such permits. In connection with the forthcoming Commission monitoring reports the companies already holding permits will sign special declarations to the effect that they are aware of their commitments and the instructions in the permits. Although measures on industrial pollution prevention caused a negative response from some companies, these will make Bulgarian companies equal partners in the global markets where environmental requirements to technologies and products are a sine qua non.

## 1.2.3. Bulgaria's Participation in International Emission Trading Schemes

Being a signatory to the Kyoto Protocol, Bulgaria participates in international trade in emissions through two of the mechanisms – international emissions trading and joint implementation (*CED Report, April 2005*). For 2005, the Bulgarian government signed five memoranda on which Bulgarian companies are implementing 12 projects as part of the "Joint Implementation" mechanism. As a result of these projects, by 2012 greenhouse emissions are expected to be reduced by 13 m tons of CO<sub>2</sub> equivalent.

The EU's Emissions trading scheme (*CED Report, July 2005*) is another instrument to meet the Community's targets to reduce greenhouse emissions under the Kyoto Protocol. Starting from 1 January 2005, installations in the Member States covered by the Directive, will limit their carbon dioxide emissions (CO<sub>2</sub>) to certain levels for the two periods: 2005-2008 and 2008-2012. There are 119 Bulgarian enterprises which applied for participation in the European Union's Emissions Trading Scheme.

The enterprises eligible to participate in the quota allocation in Bulgaria, are 173. In the questionnaires to be filled out by companies, on the basis of the average value for the total volume of emissions from the 2002-2004 period, applicants are required to state their projections for greenhouse emissions for the period between 2005 and 2012. The emissions quotas that each enterprise will receive will be allocated based on information filed by the company, while taking into account the

total emissions for the country. As part of the allocation process, a certain quantity of emission claims will be kept as a reserve. According to figures supplied by the "Energy Institute" AD, the total CO<sub>2</sub> emissions for last year from all data processed so far (85 installations) amount to 34,197,605 tons, which is almost 50 per cent of all emissions in the country for 2004. According to current expectations, about 32-34 million tons of CO<sub>2</sub> of free quotas will be allocated to Bulgaria for 2007 (or EUR 760 m at current prices).

## 2. Financing of Environmental Activities. Economic Instruments and Environmental Policy

The major economic instruments applied in environmental legislation, are: charges, penalty payments and sanctions<sup>27</sup>.

The charges collected by MEW, are mostly in the water and waste sectors. Fees on the issuing of various types of permits are also added up to that amount.

In the past year, the state administration for the first time summed up the expected income and the actual income received from environmental activities; at the end of the year an environmental deficit in the amount of BGN 580 m was announced, funds required for investment in the water sector and waste management.

According to MEW estimates, the deficit was mostly formed from overdue water use charges, inefficient concession contracts and permits.

A review on the collection rate of product charges paid by companies producing or importing packaging indicates that 85 per cent of Bulgarian companies opted to fulfill their obligations through licensed collective organizations, over 250 companies paid product charges through the Enterprise for Management of Environment Protection Activities, and portion of companies failed to pay such charges at all.

According to figures supplied by the Ministry, from the BGN 217 m in planned revenues for 2005, only BGN 8 m were collected by the Enterprise for Management of Environment Protection Activities (EMEPA). According to the MEW review report, waste management organizations failed to establish the systems for separate collection, purchasing and recycling of waste as planned according to the agreed targets, as a result of which the Waste Recycling Program approved with the Waste Management Act for 2005.

The issue of waste recovery and the scheme set up to meet recycling targets is a good opportunity to revise the role of economic instruments in environmental policy.

<sup>27</sup> Policy instruments used to address environmental domains, <http://www2.oecd.org/ecoinst/>

### 3. Environmental Policy Priorities for 2006

At the end of the calendar year, institutions in the executive authority established their future legislative priorities. As part of the government program to prepare Bulgaria for EU membership, a program for change in the legislation was drafted, which includes amendments to environmental law. In implementation of the European Commission's recommendations, the MEW also announced its priorities.

#### 3.1. Legislative Program for 2006

In the field of environment, a new Soils Act will be adopted as an environmental component, and also an Act on the Prevention and Elimination of Environmental Damage which is expected to impose on the operator who caused the environmental damage, a financial liability and the obligation to reduce to a minimum the environmental risks from its business activity at a publicly acceptable price. Also planned are amendments to the Clean Air Act, the Water Management Act, the Waste Management Act, the Biodiversity Act. As regards implementing legislation, changes are planned in the following areas:

- water: the quality and use of surface and underground water, the discharge of waste water into surface water bodies used for human consumption, the quality of bathing water, protection of water from nitrate pollution from agricultural sources;
- air: curbing the emissions of volatile organic compounds, the terms and procedure for the issue and revision of greenhouse gas emission permits and monitoring of operators of installations participating in the greenhouse emissions trading scheme, the procedure for reporting and report verification for operators of installations participating in the greenhouse emissions trading scheme;
- noise: control on environmental noise at major airports, controlling harmful noise by making buildings noise-proof from the design stage, the rules and norms for construction as regards the noise emitted during construction;
- fuels: change in the requirements on the quality of liquid fuels, and the terms and procedure for control on such fuels.

A new national program is currently being drafted on limiting the emissions from the respective pollutants pending the establishment of national ceilings and a pollutants register, also in the pipeline is a Program on the control and elimination of pollution in compliance with Directive 91/676/EC.

#### 3.2. Financing of Infrastructure Projects

Bulgaria has only limited internal financial resource for investment in the environment and in comparison with EU Member States it is a country with a poor quality of environmental infrastructure which does not meet modern standards. With regard to EU directives in the water and waste

sectors, the country has negotiated transitional periods by the end of 2010 for waste water treatment plants for human settlements with 10,000 residents and by 2014 for human settlements with 2,000 to 10,000 residents. With regard to waste management, 51 regional landfills for municipal waste must be constructed before 2009; with this, the entire territory of the country will be covered by the organized waste collection system. By comparison, according to NSI figures 80 per cent of the population is covered by the organized waste collection system, of which 99 per cent is urban population. Only 33 per cent of the rural population is covered by that system. The share of the population, using the public sewerage system in the country is 69.2 per cent, and waste water treatment plants serve about 40.5 per cent of citizens.

At the end of 2005, MEW reported on the implementation of the program for construction of regional waste landfills, according to which 21 projects became operational, 10 are under construction, and another 24 are at different stages of preparation. According to current estimates, the construction of landfills, incinerators and treatment plants for the 7 years after 2007 will require investments in the amount of about EUR 1,700 m expected to be provided from the Cohesion Fund and the European Union regional development funds, to be supplemented by 25-per cent national co-financing.



*The financial sector and financial intermediation in Bulgaria are still dominated by the banking system. As expected, the latest statistics show that curbing the credit expansion has been a temporary phenomenon. After a short drop, the credit expansion has recovered its fast pace and our concerns regarding the mid and long-term stability of the banking system are revived again. In November BNB undertook further measures for curbing the credit expansion, which we consider very positive. We continue to insist that administrative measures should be abandoned and more market-oriented ones should be adopted. It is reasonable to maintain and regulate non-banking lending and especially leasing.*

### Banking and Monetary statistics<sup>28</sup>

**Broad Money.** In September, October, and November broad money supply (M3 aggregate) increased on an annual basis by 26.6 per cent, 27 per cent and 27.6 per cent respectively, reaching BGN 24.120 b in November. That is, the broad money preserves its stable growth rate of about 27 per cent annually, while the pace is slowly increasing.

**Narrow Money.** In September, October, and November the narrow money supply (M1 aggregate) has increased by 25.2 per cent, 27.9 per cent, and 27.6 per cent respectively, reaching BGN 11.813 b in November. Thus, the narrow money supply registers stable annual growth of 27 per cent.

**Monetary Basis.** In September, October, and November the monetary basis reached BGN 7.837, 7.828, and 7.780 billion respectively, registering 34 per cent growth in the past 12 months. Notwithstanding the reported fall in the monetary basis during the last two months, the growth during the last 12 months is quite high (34 per cent), which drives the high growth rates of both broad and narrow money.

**Net Foreign Assets.** Net foreign assets are one of the main components of both the monetary basis and the broad money supply, which on the whole explains the growth in these two money indicators. In November net foreign assets increased to BGN 13.098 b, registered slight drop to BGN 12.824 b in October 2005 and annual growth of 18.2 per cent against 13.5 per cent and 15.1 per cent during the previous two months. Net foreign assets are defined as foreign assets less foreign liabilities. The annual growth in foreign assets is 17.3 per cent in October against 21.7 per cent in September 2005, whereas for foreign liabilities it is 26.4 per cent against 38.4 per cent in the previous month.

**Net Domestic Assets.** Net domestic assets, together with net foreign assets, are the second major component of broad money. In November they amounted to BGN 11.020 b and for the previous two months their amount was BGN 11.098 b and BGN 10.836 b respectively. In November growth was 41 per

cent year on year. Therefore, it is clear that net domestic assets grow faster than broad money, in contrast to net foreign assets that grow at a much slower pace. Under these circumstances, we can conclude that the fast growth of broad money is generated by net domestic assets.

**Money Multiplier.** In the past three months the money multiplier registered very slow growth at levels 3.03, 3.06 and 3.10 respectively in September, October and November. Twelve months ago, the multiplier was 3.26, and during the first 6 months of 2005 it fluctuated in the 3.20 - 3.33 range. That is, we notice a moderate drop in the multiplier during the past 12 months, which is probably due to BNB measures, so the growth in the last two months should be interpreted as moderate and within the normal range.

**Deposits.** The annual increase in demand deposits with maturity of up to 2 years is 31.3 per cent in October, and 34.2 per cent in September 2005, whereas the growth in time deposits (up to 3 months) is 10.7 per cent compared to 9.5 per cent in the preceding month.

**Receivables from the Non-governmental Sector.** In November the non-governmental sector receivables amounted to BGN 17.888 b, registering 32.5 per cent growth in the past 12 months. In October 2005 these receivables amounted to BGN 17.607 b with 34.7 per cent growth year on year against 35.9 per cent annual growth in September 2005. This means that growth is delayed but remains much above the desirable levels as specified by BNB.

**Domestic Credit.** Domestic credit is the sum of receivables from the public and the non governmental sector and is the main component of the net domestic assets. In fact, it is the total credit resource within the economy and is the best indicator for the credit expansion in the country. In September, October and November the domestic credit amounted to BGN 16.803, 17.166 and 17.147 b, while in November the annual growth rate was 37.9 per cent. In practice, domestic credit growth is significantly higher if we consider the fact that in May and June there was a domestic credit drop due to the BNB March and April regulations. This rate of almost 38 per cent is significantly higher with respect to the target of 30 per cent set by BNB, which was the reason for issuance of the BNB November 2005 regulation, which will be further discussed in the next section. Moreover, fast growth of broad money was explained with the fast growth of net domestic assets; now it becomes clear that the fast growth of net domestic assets is due to the fast growing internal credit, i.e. to credit expansion. In brief, the credit expansion drives money supply.

**Credits.** The annual growth of loans to non-financial enterprises is 24.1 per cent against 25.9 per cent for the previous month. The increase of loans to households and the NCOSH (non-commercial organizations serving the households) is 62.4 per

<sup>28</sup> As per the official press release and the official monetary statistics of BNB, [www.bnb.bg](http://www.bnb.bg)



cent per year against 63.5 per cent in September 2005. In the loans to households and NCOSH lending, mortgage loans register the highest growth of 113.3 per cent on an annual basis against 121.2 per cent in September 2005.

**Assets.** At the end of October the banking system assets reached BGN 30 015 493 thousand. Growth from the previous month is 1.0 per cent (BGN 306 958 thousand). The change is a result of the increase of net loans to non-financial institutions (NFI) and receivables on reverse repo-agreements. Receivables from financial institutions shrunk by BGN 210 813 thousand (4.4 percentage points) and the available resources were reallocated to investment in securities (repo-operations, investment and operations portfolio). At the end of October the net credits released to non-financial institutions reached the amount of BGN 16 762 216 thousand and remain the major item in assets' structure with a share of 55.9 per cent.

**Deposits.** The growth of banking system assets was financed by increase of deposits of non-financial institutions and other clients, which as of 31 October 2005 increased by BGN 370 808 thousand (2.0 per cent) compared to September. During the reported month, the upward trend in the deposit base from enterprises and households compensates the drop in deposits of financial institutions decreasing by BGN 71 689 thousand (2.0 per cent). The main share in the increase of deposits of non-financial institutions have demand deposits that increased by BGN 229 552 thousand (3.0 per cent) in the reviewed month. At the end of October the total banking system deposit base reached BGN 22 950 973 thousand and its share in the balance sheet liabilities is 76.5 per cent. Increase against the preceding month is 1.3 per cent (299 119 thousand), and is most notable for the deposits in BGN (increasing is by BGN 151 306 thousand).

**Funds for Financing.** In October there was a decrease of BGN 88.844 in obligations under agreements for repurchase of securities, other liabilities and short-terms lending resources. The reduction of these items is largely compensated by the increased volumes of long-term loans and debt capital (hybrid) instruments. Total funds for financing (deposits, long and short-term lending resources) amount to BGN 25 355 231 thousand and the increase compared to September is by 1.5 per cent (BGN 362 326 thousand).

**Bank Capital.** The balance aggregate called "bank capital" reached the amount of BGN 3 316 831 thousand; the positive change of BGN 42 970 thousand (1.3 per cent) compared to September is due to the increased current profit of banks.

**Credit Structure.** In October, the net credit portfolio increased by BGN 369 290 thousand (2.3 per cent), with credits in euro registering the highest growth (182 678 thousand), followed by credits in BGN (175 553 thousand) and other currencies (11 059 thousand). The biggest absolute change (134 030 thousand) is

reported on other commercial loans. During the same period most dynamic were housing mortgage loans with a monthly increase of 4.3 per cent (75 160 thousand). The newly released consumer loans amount to BGN 126 445 thousand from the monthly increase of the credit portfolio. Growth in customer loans is 3.3 per cent against the previous month and 52.2 per cent on an annual basis.

**Profit.** The profits reported by the banking system at the end of October 2005 amount to BGN 502 921 thousand. Compared to the same period of last year, the financial result increases by 37.4 per cent (BGN 136 817 thousand), while compared to September 2005 the increase is 9 per cent (BGN 41 400 thousand).

### BNB Regulations

**While BNB regulations of March and April had a short-term effect in curbing the credit expansion, which was seen in domestic credit drop in May and June, in July the credit expansion resumed its normal pace. In these circumstances, we forecasted that BNB will issue a new regulation, which was released in November. BNB's regulation issued of November 10 contains the following two major changes<sup>29</sup>:**

#### Change 1

Introducing a progressive scale of additional reserve applicable as of the first quarter of 2006. The first period of maintaining additional mandatory minimum reserves under this scale commences on May 4, 2006. Progressive scale of additional mandatory minimum reserves is as follows:

1. the double amount of the value by which the total amount of released credits during each basis period exceeds the proportion set forth in Art. 9, para. 1, item 1 and para. 3, provided that this proportion is exceeded by less than 1 per cent;
2. the triple amount of the value by which the total amount of released credits during each basis period exceeds the proportion set forth in Art. 9, para. 1, item 1 and para. 3, provided that this proportion is exceeded by less than 2 per cent;;
3. four times the amount of the value by which the total amount of released credits during each basis period exceeds the proportion set forth in Art. 9, para. 1, item 1 and para. 3, provided that this proportion is exceeded by 2 or more than 2 per cent.

#### Change 2

The following changes were made to Ordinance № 9 on the Evaluation and Classification of the Risk Exposures of Banks and Allocation of Provisions to Cover the Impairment Loss:

<sup>29</sup> From the BNB press release, [www.bnb.bg](http://www.bnb.bg)

1. Special provisions for exposures under surveillance increase from no less than 10 per cent to no less than 20 per cent, when the exposures are to physical persons.
2. Special provisions for substandard exposures increase from no less than 50 per cent to no less than 75 per cent, when the exposures are to physical persons.
3. Due to the stable quality of corporate portfolio in current balance of commercial banks, there is no need to adopt more restrictive policy with regard to these credit provisions.

Analysis of these changes shows several major improvements in measures, as well as some serious weaknesses. The first substantial improvement is the abolished minimum liquidity requirement of 60 per cent<sup>30</sup> when applying the measures. We would like to remind that in the March and April regulations the requirement was to affect both credit growth and the minimum required liquidity coefficient of 60 per cent. Our latest interpretation of the Ordinance makes us believe that the requirement for minimum liquidity is no longer valid and the focus is only on portfolio growth. This is a significant improvement in the effectiveness of the Ordinance.

The second improvement relates to the progressive scale of "punitive" additional mandatory reserves. The new scale is too steep and discourages lending over the set "limits". Its effect will certainly be a decisive factor in curbing the pressure of the banks that surpass the limits and "pay the fine".

The first weakness is the belated implementation of the "punitive" reserve: the first quarter of 2006 will be the first period to maintain additional mandatory minimum reserves according to this scale and will commence on May 4, 2006. This gives a chance to aggressive banks to continue their expansion until the end of 2005 under the old conditions and gives them enough time to adapt to the new requirements and find the needed "loopholes" for circumvention.

The second weakness is in bringing different segments into the credit market and in their scope of regulation. Certainly, the division into different segments will lead to market distortions, at first place. Moreover, very often the nature of business is such that a single loan can be classified to several market segments, therefore such a regulation will intentionally distort their classification. Third, the regulation will encourage many additional incentives for circumvention of requirements, such as buying a house on a leasing (lease with an option to purchase), known as "financial leasing". The fourth concern is that many banks will undertake unproductive re-classification of their credit portfolios in order to shrink "target" sectors and expand "non-target" ones. In the end, this approach will result in market distortion and successful formal implementation of new

regulations, which in fact will be a failure of the real objective of this approach.

The third weakness is in the serious omission in all existing BNB financial sector regulations, namely the lack of regulations on *non-banking* lending, and most specifically, lease credit. We must once again stress the fact that lease credit, like any other credit in the economy, increases the money supply and generates inflation. Moreover, lease increases the purchasing power of individuals and businesses and is practically instrumental to the increase of imported (investment) goods, i.e. to foreign trade deficit. Under these circumstances, creating regulations on lease crediting is a major necessity for the long-term sustainable development of the Bulgarian financial and lending system. It is a public "secret" that non-banking leasing companies are the main instrument for circumvention of BNB's restrictive measures. BNB has made some timid steps in this direction by demanding from lease companies to report on their activities, and probably this is only a prelude to the development of regulations on their activities.

The fourth weakness in the regulations is the non-market approach to regulatory measures, i.e. the need to increase the cost of the credit resource for the borrower. Even in a currency board monetary system, the Central Bank is provided with an effective instrument to implement the monetary policy, which is the required minimum reserves. The use of this instrument may have a major role in curbing credit expansion. BNB should keep on increasing the required minimum reserve of all banks, without any exception, rather than applying progressive scale depending on the credit growth rate. In other words, general increase in the cost of lending resource of banks is needed which will also raise the cost of credit.<sup>31</sup> Certainly, this will affect the profitability of commercial banks too, but at the end of the day, there is no other market mechanism that may successfully achieve the measures' goals.

### Banking Sector Development during 2005

Banking sector development during 2005 is characterized by aggressive competition between commercial banks resulting in significant increase in the volume of new loans and in the number of innovative lending products and services. This development was achieved due to low interest rates in the Eurozone and

<sup>30</sup> The exact wording of the Ordinance is the following: "The sum of released loans and the risk-weighted off-balance items made equal to balance sheet assets, decreased by the amount of their own capital, shall not be more than 60 per cent of the debt capital from persons other than banks and non banking financial institutions".

<sup>31</sup> In fact, BNB proceeds as follows: attributes to each bank a "quota" of 24 per cent loan increase up to which level the price definition follows the market, beyond that quota the price is administratively doubled, and subsequently tripled. In order to illustrate this approach, we may use the following example: the quantity of sugar is limited to 1 kilo per person per month; for the second kilo the customer shall pay a double price, and for the third kilo – a triple price. Or a baker man (a cigarette vendor) has a set administrative quota of 1000 breads (packs of cigarettes) per day to be sold at the market price; any second bread (pack of cigarettes) after the 1000<sup>th</sup> shall be sold at a double price and after, for example, the 1100<sup>th</sup> bread (pack), the price shall be triple. These examples show that if there are big quantities of cheap sugar, bread or cigarettes such limitations will not achieve the desired goal since the vendors and customers will definitely find a way to avoid these "artificial" prices. If the state really wants to reduce the use of sugar (as it causes diabetes), bread (leads to overweight) or cigarettes (due to risk of cancer), a much more effective measure will be to impose an excise duty that will increase the price of these goods, rather than impose the above scheme of administrative pricing. It is obvious that the excise duty will affect the profit of vendors, but will also administratively limit the consumption notwithstanding the big supply, thus both the consumer and the vendor/producer will be protected. It is impossible to have it both ways. This BNB regulation is trying to protect both consumers through lower interest rates and the banks through higher profits, while actually aiming to limit the number of loans and maintain the banking system stability.

significant foreign lending resource, notwithstanding BNB's attempts to limit the increased lending activities in the sector.

Another major trend in the banking sector was the consolidation wave due to completion of the privatization in the sector during 2004. As we pointed out in our previous report, based on analysis of the efficiency and profitability of commercial banks according to their size, we expect that this consolidation process will accelerate in 2006.

Another improvement was the upgrade of the Central Loan Register and the establishment of the First Private Credit Bureau. This will improve in many ways the amount of information provided to banks in their lending activities and will improve risk management in the system.

As a result of the aggressive credit expansion during the past few years, a stable and alarming trend of increase of bad loans has been verified. We should give credit to the BNB requirement for increased provisions for these loans. We are anticipating that some banks will "burn their fingers" with the requirements for increased provision and will undertake a more reasonable approach in their lending practices.

Competition in the lending sector established some stable trends too. First, as we mentioned before, this is the aggressive credit expansion aiming at bigger market share. Second, as a result of the cut-throat inter-bank competition, spreads between the interest on deposits and credits shrunk. Third, the non-banking lending niche was established and strengthened, which, in our opinion, was facilitated by BNB's regulatory omissions in this sector. The competition also resulted in introduction of new banking products and services that benefit customers. Finally, we have to conclude that despite the aggressive credit expansion, competition in the banking sector has many positive effects in all economic sectors and should be further encouraged.

During 2005 two segments in bank lending stood out – the mortgage and the SME sectors. After satisfying the big businesses' credit demands in 2004, in 2005 the expansion strategy of commercial banks targeted the households through housing credits. The rising prices of real estate during the past two years gave a reason to banks to develop aggressive approach in the sector with the awareness that real estate is a solid asset providing excellent collateral for their loans. SMEs crediting was the other expansionary segment where banks adopted an approach similar to the consumer approach – they financed mainly businesses providing sufficient collateral for the loans. Lending in both sectors was based not on borrower's income, but on his assets. This is a trend established in the past five years in the economies with developed financial systems and is described in western literature as a transition from "earnings-based lending" to "asset-based lending". The interpretation of this transition is a topic of fervent debate

between the two major economic schools: for neoclassicals, this transition is natural, therefore posing no concerns, whereas according to the Austrian school this transition feeds speculative bubbles, malinvestments, artificial economic booms followed by an inevitable financial collapse.

In 2005 the cut-throat competition of banks for market shares established a new phenomenon on the banking market – promotional interest rates. Initially these were lower interest rates for the first year of the loan; subsequently they were extended to include also the second and third year. Even loans with zero interest rate for the first year were offered. However, this really positive development came along with many negative features, such as a lot of concealed clauses, hidden fees and commissions, customer confusion, vagueness with regard to total price of the loan, client captivity, etc. Finally, experts are almost unanimous that these promotional interests are essentially cheap marketing tricks aiming to "capture" more customers, rather than a real reduction in the price of loans. However, this approach of commercial banks shows how strong the competition is, and in the long run it will definitely provide benefits to borrowers.

During the past year the banking sector had the important task to prepare for EU accession and the forthcoming adoption of BASEL 2 requirements to the surveillance and capital adequacy of commercial banks. In this regard, we applaud the proactive legislative and regulatory activities of BNB for synchronization of national with the European legislation and for the preparedness of the Bulgarian banking system for the approaching accession.

Another important event in the banking sector was the privatization of the Banking Card Payments Organization (BORICA). This sale transferred 63.76 per cent of BORICA's equity to 25 commercial banks while remaining shares were kept by BNB. It is expected that the sale will result in more efficient use of the system by commercial banks, improved and diversified services, better market-oriented tariffs and their eventual reduction, general reduction of risks associated with use of the system and improved security of services. This privatization transaction came along with rapid development of the credit cards market. Until recently, owning a credit card was considered a privilege, whereas in 2005 significant percentage of the Bulgarian middle class already own credit cards. This is the segment with the highest profitability for banks implying excellent development potential for 2006.

Another major event during the year was the bankruptcy of the International Bank for Reconstruction and Development (IBRD). Unfortunately, this bankruptcy had no sobering effect on other commercial banks. Instead, it revealed another major problem in the banking system—deposit insurance. It turned out that IBRD has contributed to the Deposit Guarantee Fund about 50 times less than the resources which the Fund has to

pay out to reimburse depositors. The problem is not the lack of guarantee funds, but the lack of market-based insurance premiums payable by each commercial bank according to their bankruptcy risk. At present, insurance premiums are equal for all banks, thereby effectively “punishing” prudent creditors and favoring the most aggressive ones. The bankruptcy revealed this “old” problem and intensified the public discussion for a better market approach in deposit insurance.

Our expectations for 2006 are that the trends of 2005 will persist. BNB will continue to exercise its regulatory functions and commercial banks will find new ways to circumvent regulations. Credit expansion will continue at a slower pace, but still much higher than BNB’s targeted rates. Most probably, the share of bad credits will increase. The real estate sector will remain the leader in credit expansion. The rapid development of lease crediting will persist. Mergers and acquisitions will continue the consolidation trend. Banking competition will continue to shrink interest spreads and to offer innovative lending products. Preparation for EU accession will continue. The deposit insurance debate will most probably end up with a new pricing scheme.



*The insurance sector in Bulgaria reported a growth of 35 per cent in the first nine months of 2005. The structure of the insurance portfolio of insuring companies also underwent dynamic changes following the European market trends. In December important legislative changes were made in order to harmonize Bulgarian with the EU legislation. With these changes the sector may now operate in free market conditions, but also the requirements are higher so as to cope with the dynamics of changes. Concerns were reinforced by the two cases of termination of licenses of insurance companies by the Financial Supervision Commission (FSC). In this situation very important are the regulatory measures of FSC and other regulatory authorities accompanying the liberalization process, especially in the area of the mandatory insurance.*

## Regulatory Changes

Regulatory changes were made due to the need to align Bulgarian mandatory insurance legislation with EU regulations by adopting the new Insurance Code. The Monitoring Report of the European Commission for 2005 emphasizes the need for this to be accomplished by the end of 2005. Very important issue for Bulgaria is the insufficient coverage of the third party liability insurance. The Report states that 45 per cent of the registered motor vehicles are not insured which may be a major obstacle to the adoption in Bulgaria of the Green Card International Agreement. The legislative changes liberalize the market, which means that insurance companies are free to fix premium amounts.

In parallel with this they point out the need for new regulatory measures that can ensure the market stability. Steps were taken for improvement of the information exchange system between the Ministry of Interior, Financial Supervision Commission and the Guarantee Fund, which will control the scope of the motor third party liability insurance and will be used as a basis for imposing sanctions on violators. The goal set by the European Commission is to reach 90 per cent of the scope of this insurance.

- Insurance Code adopted on December 8, 2005.
- Art. 77 regulates the acknowledgment of insurers' receivables from re-insurance companies as insurance reserve coverage. Up to 80 per cent of receivables' amount is acknowledged as a reserve, provided that the re-insurance company has a credit investment rating issued by any of the rating agencies approved by the FSC; up to 50 per cent, if its rating is out of the investment ones, and up to 20 per cent, if the re-insurance company has no rating. Thus the quality and stability of insurance companies' portfolio will be controlled through the re-insurance companies.
- Art. 283 regulates the information exchange between the National Bureau of Bulgarian Car Insuring Companies, the Ministry of Interior and the Guarantee Fund. This measure

is aiming to increase the control of running vehicles that have no valid motor third party liability insurance.

- Ordinance amending and supplementing Ordinance № 18 on the mandatory insurance under Art. 77, para. 1, item 1 and 2 of the Insurance Act.
- § 2 regulates the abolishment of the minimum mandatory insurance premium under motor third party liability insurance while insurance companies have to set sufficient premium amount to ensure liabilities servicing and accumulation of the necessary reserves. The Insurance Supervision Directorate at FSC is responsible for the implementation and may require insurance companies to adjust their premiums. It is expected that in addition to satisfying the free market requirement, the abolishment of the minimum premium amount will increase the affordability, respectively the scope of this insurance.
- § 9 regulates the information flow from insurance companies to regulatory institutions – reference on the policies signed shall be submitted twice a week to the Financial Supervision Commission. This measure aims at improving the information control system.

The implementation of legislative measures is part of the joint campaign of the Financial Supervision Commission, the Ministry of Interior and the Ministry of Finance for increased scope of the motor third party liability insurance, which includes also measures to improve the general insurance culture of the population. They are needed because of the dynamic regulatory environment and the specifics of the insurance products – when it comes to mandatory insurance, the most important competitive advantage is the price aspect which may result in dumping and destabilization of the market, as well as because of the higher responsibility ceilings.

## Market Statistics<sup>32</sup>

In 2005 the insurance services market registered rapid growth. In the first nine months of 2005, total income from premiums amounted to BGN 741 363 597 or up 35 per cent compared to the same period of 2004. However, total market growth registers delay standing at 41.5 per cent for the first six months of 2005 on the same period of 2004. The market dynamics is determined by motor third party liability and Casco insurances which account for 65 per cent of total insurance market revenues. The adopted legislative changes relating to the liberalization of minimum insurance limits for third party liability insurance are expected to have a big impact on the 2005 market indicators, since in 2004 the income from motor third party liability premiums represented 32 per cent of the total insurance market revenues, and 40 per cent of all policies are usually signed in the last quarter of the year. Lower insurance premiums are expected as a result of the liberalization and competition between different insurance

<sup>32</sup> The reported data are those of FSC for 2004 and the first nine months of 2005; official data for the last quarter of 2005 are not published.



## INSURANCE SECTOR

companies as well as of the broad national campaign promoting mandatory insurance.

In the general insurance, the share of property insurance is not matching general market trends. Despite the forecasts for a bigger demand of these types of insurance products due to the natural disasters during the summer of 2005, the nine-month reports show a drop. The cargo goods in transit (Cargo) insurance, fire and natural disasters, as well as household property insurance, have lost their market share, and the biggest drop is in the revenues from fire and natural disasters insurances. In 2005 their share in the general insurance revenues has decreased to 15.79 per cent, compared to 19.32 per cent in 2004.

As per data for the first three quarters general insurance has a share of 87.4 per cent in the total insurance market, while life insurance has only 12.4 per cent or up only 1.37 percentage points against the same period of 2004. However, the increase in life insurance is 51.44 per cent, while the increase of the general insurance share is 32.9 per cent. Considerable growth registers the share of Life Insurances, specifically Life, Pension and Annuity insurances, where the increase is of 215.78 per cent (with a relative share of 14.36 per cent in the life insurance sector). The world markets' structure shows that the shares of both insurance sectors are quite equal, which means that in the future life insurance will be growing at a higher pace compared to general insurance.

Insurance growth drivers, i.e. insurances having higher relative share in the revenues from premiums as well as the highest growth, are mostly insurances with higher indemnity quota compared to the total quota in the sector (see tables below). This refers to third party liability insurance, road motor vehicles insurance (Casco), Life Insurance in general. The low-indemnity property insurances with a relatively high share register slow growth and the "Damage of property" insurances registers decrease of revenues by 14.02 per cent. If this trend persists, a lower profit rate of the insurance companies is to be expected compared to the growth in the premiums revenue rate.

Table 9. General Insurance

General Insurance	Premium income growth (first three quarters of 2005), %	Damage quota %	Share (2004) %
Personal accident insurance	53.3	14.22	1.93
Including mandatory insurance for personal accident of passengers in the motor vehicle	55.86	5.01	0.68
Illness insurance	180.35	165.21	0.00
Road transportation insurance	37.96	47.14	37.04

<sup>33</sup> Paid insurance installments/income from premiums by type of insurance ratio, 2004 data

Railway transportation insurance	686.11	0.00	0.02
Aviation insurance	174.84	5.07	0.97
Marine insurance	80.93	64.47	0.83
Goods in transit (cargo) insurance	-4.29	18.44	1.97
Fire and acts of god insurance	13.09	13.28	19.32
Property damage insurance	-14.02	11.73	6.10
Third party liability of owners, users, holders and drivers of motor vehicles	44.98	36.09	24.30
Including Green Card insurance	2.34	52.50	5.88
Third party liability, air crafts	29.39	0.00	0.69
Third party liability, vessels	55.31	0.00	0.15
General third party liability	42.43	30.52	2.85
Credit insurance	63.58	7.82	0.47
Guarantee insurance	-13.81	6.86	0.75
Sundry financial losses insurance	82.89	14.52	1.49
Legal fees insurance	-	-	-
Travel insurance (assistance abroad)	4.61	22.51	1.12
<b>Total:</b>	<b>32.91</b>	<b>32.16</b>	<b>100.00</b>

Table 10. Life Insurance

Life Insurance	Premium income growth (first nine months of 2005) %	Damage Quota <sup>2</sup> %	Share (2004) %
Life and annuity insurance	60.56	40	70.74
Including Life Insurance	42.69	42	56.38
Including pension or annuity insurance	215.78	26	14.36
Marriage and kids insurance	11.32	48	3.19
Life Insurance in an investment fund	59.90	26	7.66
Permanent health insurance	17.70	59	1.98
Buy back of capital	-	-	-
Complementary insurance	4.06	46	8.22
Personal accident insurance	73.40	26	8.22
<b>TOTAL:</b>	<b>51.44</b>	<b>39</b>	<b>100.00</b>

Source: FSC

### Suspension of Licenses

During the last quarter important events took place in the sector. Licenses of two insurance companies – Insurance Company "Hildon" AD (Insurance Company "Jupiter" AD) and the International Insurance Company "Europe" AD have been suspended.

- On 3 October 3 2005 FSC suspended the insurance activities permit of IC "Hildon" AD after finding violations such as illegal denial of payment of indemnification, delays and partial payment of obligations under insurance contracts, underestimation of insurance reserves by at least BGN 909 thousand, at least 95.2 per cent shortage

<sup>34</sup> Correlation between paid insurance payments and premium revenues by insurance types according to data from 2004.

of assets to cover the reserves, reported higher financial result by at least BGN 3 519 thousand due to inaccurate accounts. IC "Hildon" AD had a share of 1.14 per cent in 2004 general insurance premium revenues.

- On December 22, 2005, FSC suspended the insurance activities permit of the International Insurance Company "Europe" AD for the following reasons: default of obligations, underestimation of obligations by BGN 800 thousand, shortage of assets to cover the reserves amounting to 53 per cent, reported financial result increased by BGN 670 due to inaccurate accounts and by BGN 300 thousand due to overvalued shares in other companies. The company has a share of 0.13 per cent in 2005 general insurance premium revenues.

These events require due consideration because of the fact that since 1998 no license of Bulgarian insurance company has been suspended. There is a potential threat that the minimum premiums liberalization may lead to bankruptcy of other companies due to the fact that with the liberalization of insurance premium prices insurance companies may not be able to collect enough funds to cover the required insurance reserves. In order to prevent such market scenario of major importance is the efficiency of FSC's regulatory activity because the provisions of the Insurance Code delegate important control functions to FSC. In a press release FSC announced that they are carrying out intensive check ups of liability insurances in order to validate the legitimacy of marketing agents and illegal reduction of prices, either overt or covert, offered as a bonus to the insurance.

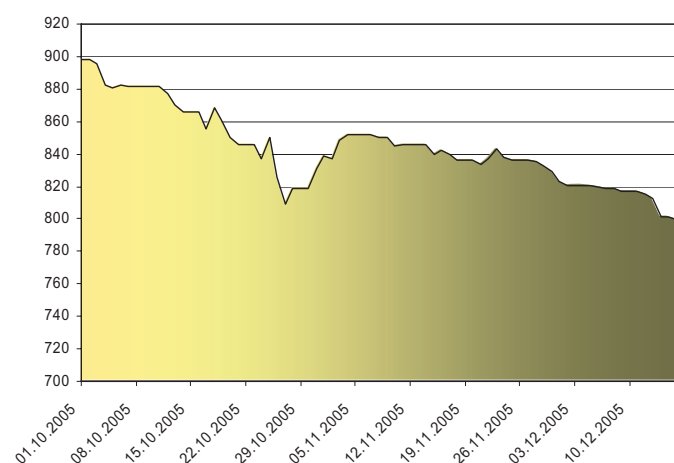
As additional measures for protection of the interests of the insured persons, in early December a bill for establishment of a Security Fund to be financed by insurance companies was placed on the parliament agenda. The resources of this Fund will be used to cover within certain limits obligations to clients of companies with suspended licenses. The bill was contested with the motive that it would stimulate the abuse by companies, and, therefore, was rejected. This means that for the time being the state has no tools to guarantee the interests of insured persons, which considering the concerns with regard to the market stability, will result in additional tension.

Notwithstanding the good results of the major companies traded, the capital market ended the year with a drop of indexes. The turnover increased with smaller number of transactions, which is typical for underdeveloped markets like the Bulgarian one which depend on single package transfers. Compensatory instruments registered drop in prices by one third. The issue of the institutional future of Bulgarian Stock Exchange and Central Depository within the capital markets internationalization was brought to an active discussion.

As regards the capital market, the last quarter of 2005 was a "copy" of the second quarter. After the high increase in prices of almost all positions registered in the period January – March and July – September, big drop was reported in the period April – June and October – December.

For example, SOFIX hardly reached 900 points in early October and with the subsequent drops, it reached a little below 800 points at the year end. The drop of more than 10 per cent was further affirmed by the fluctuations of the more balanced BG 40 index, which from 140 point dropped to a little over 130. Many experts found the downward market movement at the end of the year somehow surprising, since many public companies reported good financial results for the third quarter.

Figure 20. SOFIX development in the period 01.10.2005-31.12.2005

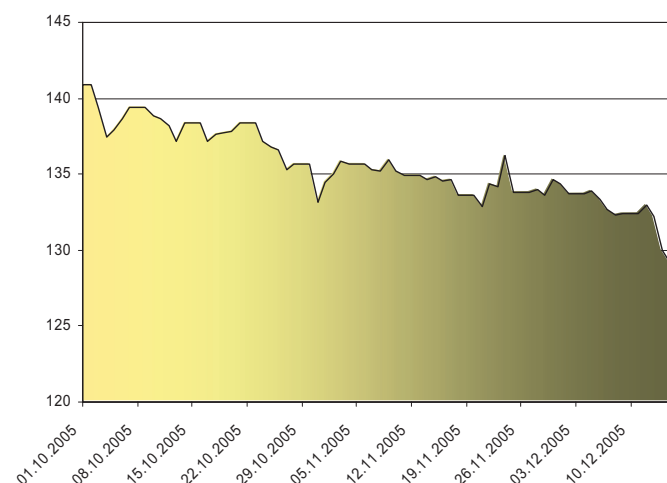


Such an irrational reaction is not new for the Bulgarian market and shows some inefficiency elements. Since the higher price of a company is directly relating to the right presentation of its good financial standing, we can conclude that after such reaction of the market companies will not be motivated to pay due attention to their publicity.

Other analysts believe that the drop was not surprising insofar as the common opinion is that continuous upward movements are in history, as there are no grounds to presume that the indexes of Bulgarian Stock Exchange will always be in the top three in Europe in terms of growth. On the other hand, currently much more important is the market liquidity which maintains

the levels of the previous quarter, rather than the raise in the prices of registered issues. This is the right direction to invest all efforts in, because the direct methods which the government applied to stimulate the capital market, are now exhausted.

Figure 21. BG 40 development in the period 01.10.2005 – 31.12.2005



Therefore, we have to pay attention to several major factors. First, new issuers of securities must be attracted. Second, it is important to bear in mind that the information about fraud with securities and compensatory instruments compromises the fragile image of the capital market, thus special attention shall be paid to the control over the trading with securities. Third, technological development of the stock exchange and improved service quality in particular with regard to the distribution of information is another issue to consider.

The lack of interest to financing through the capital market in Bulgaria is also confirmed by the fact that during the last quarter there were no new issuers registering their issues of shares for trading, not considering the fast growing contractual funds and special investment purpose companies. During the reporting period, two new special investment purpose companies were registered and other two increased their capital for the second time. Four contractual funds have been registered for trading, but the practice shows that they have been actively traded on the counter, thus no large turnover is to be expected from this type of positions. Nevertheless, their role of strong institutional investors on the capital market is very important as they may stimulate the liquidity. However, this function of contractual funds is now under question due to the fact that they have the necessary resource but do not have investment opportunities. It's a fact that the average market free-float is about 10 per cent. With total market capitalization of BGN 8.2 b this means that maximum BGN 800-850 million could be invested on the stock exchange.

## Market Capitalization

The stock exchange capitalization at the year end dropped by about 10 per cent down to BGN 8.2 billion, which was due to the

extensive drop of prices during the whole quarter. Practically, this is the lowest value registered this year after the stock-exchange privatization of the Bulgarian Telecommunications Company AD.

Big movements in this indicator are not to be expected any time soon, despite the fact that the market reorganization planned by the stock exchange will definitely influence it. "Transfer" of capitalization to the official market at the expense of the unofficial market is expected, insofar as prepared criteria aim at registering the higher quality issuers for trading on the official market, as well as at transferring companies which are public by legacy but not in nature to the so called registration market. Notwithstanding the internal market restructuring, no big changes in the total capitalization are to be expected, provided that there is no big raise or drop in prices.

Table 11. Market Capitalization

Market Capitalization	31.12.2005	30.09.2005	30.06.2005
Official equity market, segment A	116 842 539,7	123 770 590,75	113 699 897,35
Official equity market, segment B	669 220 121,96	775 156 803,02	645 816 639,66
Official equity market, segment C	1 316 305 253,48	1 440 137 155,72	1 178 390 108,27
Unofficial equity market	6 144 263 846,33	6 751 007 881,87	6 535 227 706,27
<b>TOTAL</b>	<b>8 246 631 761,47</b>	<b>9 090 072 431,36</b>	<b>8 473 134 351,55</b>

### Turnover, Volumes and Liquidity

Over the last quarter the turnover raised by 66 per cent, but it was due to several pack transfers totaling over BGN 50 million each. The number of transactions indicator shows a drop in the market activity. Moreover, traditionally the last days of the year register record turnover that some time amount to more than twice the average daily turnover during the year.

Encouraging is the fact that despite the small number of companies registered for trading the official market maintains good liquidity level. In this case, 10 per cent of the companies register 1/3 of the total number of transactions in securities and more than half of the transferred lots. Persistence of this trend and the planned reorganization of markets will help the stock exchange official market to become more representative and prove the qualities of each registered issue.

Table 13. Average daily trade values of the Bulgarian Stock Exchange – Sofia, for the third and fourth quarter of 2005

Market	01.10.2005-31.12.2005		01.07.2005-30.09.2005	
	Turnover	Transactions	Turnover	Transactions
Official equity market, segment A	185 185,56	51,59	130 337,63	69,05
Official equity market, segment B	447 940,23	22,38	109 233,42	25,77
Official equity market, segment C	2 145 018,12	274,93	661 450,62	289,63
Unofficial equity market	4 073 501,73	386,27	2 647 757,70	372,82
Unofficial bond market	949 076,80	3,54	787 924,22	2,00
Official corporate bond market	139 103,59	0,52	99 765,30	0,79
Unofficial market of other securities	63 655,22	14,05	2 991,07	2,40
Unofficial market of compensatory instruments	318 472,82	71,59	315 629,92	68,08
IPO equities market	0,00	0,00	44 872,10	1,16
IPO other securities	4 577,94	0,95	3 657,50	0,89
<b>Total</b>	<b>8 326 532,01</b>	<b>825,80</b>	<b>4 803 619,49</b>	<b>832,60</b>

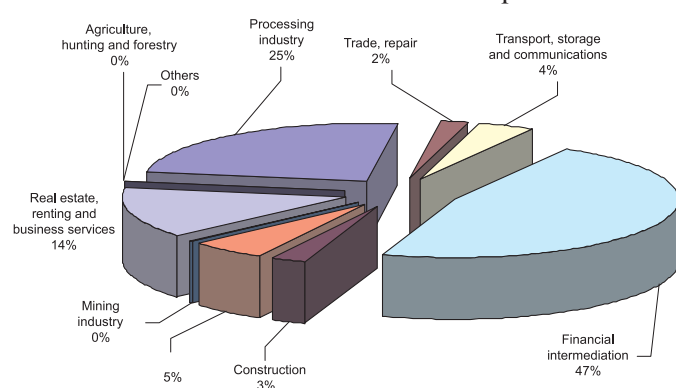
Table 12. Statistics by markets of the Bulgarian Stock Exchange – Sofia, for the third and fourth quarter of 2005

Market	01.10.2005-31.12.2005			01.07.2005-30.09.2005		
	Lots	Turnover (BGN)	Transactions	Lots	Turnover (BGN)	Transactions
Official equity market, segment A	2 294 093	10 370 391,33	2 889	2 248 819	8 080 932,89	4 281
Official equity market, segment B	4 249 743	25 084 652,72	1 253	968 700	6 772 472,20	1 598
Official equity market, segment C	24 125 211	120 121 014,63	15 396	7 822 349	41 009 938,67	17 957
Unofficial equity market	21 439 677	228 116 096,83	21 631	18 534 961	164 160 977,32	23 115
Unofficial bond market	36 060	53 148 301,01	198	28 905	48 851 301,51	124
Official corporate bond market	6 716	7 789 800,77	29	5 749	6 185 448,81	49
Unofficial market of other securities	3 852 093	3 564 692,32	787	781 898	185 446,60	149
Unofficial market of compensatory instruments	26 947 726	17 834 477,93	4 009	28 093 115	19 569 054,97	4 221
IPO equities market	0	0	0	645 731	2 782 070,46	72
IPO other securities	900 000	256 364,84	53	300 000	226 764,70	55
<b>Total</b>	<b>83 851 319</b>	<b>466 285 792,38</b>	<b>46 245</b>	<b>59 430 227</b>	<b>297 824 408,13</b>	<b>51 621</b>



As a result of the increased total stock exchange turnover, its daily average values raised by 72 per cent, but as we mentioned before, this increase is not representative especially if we consider the slight drop in the average daily number of transactions. Encouraging is the fact that the unofficial equity market registers growth, although minimal. We have to consider also the fact that in periods when the average number of transactions was over 1000, most of them were transaction with compensatory instruments and with the already deregistered investment bonds that accounted for more than 20 per cent of total transactions.

Figure 22 Structure of trade by industries in the fourth quarter of 2005



During the past quarter the structure of trade by sectors remains almost unchanged. Holding structures have the biggest market share again, followed by companies from the processing industries. This trend will not change any time soon, or as long as there are not many new and attractive companies from sectors currently not represented on the exchange, which could attract investors' interest.

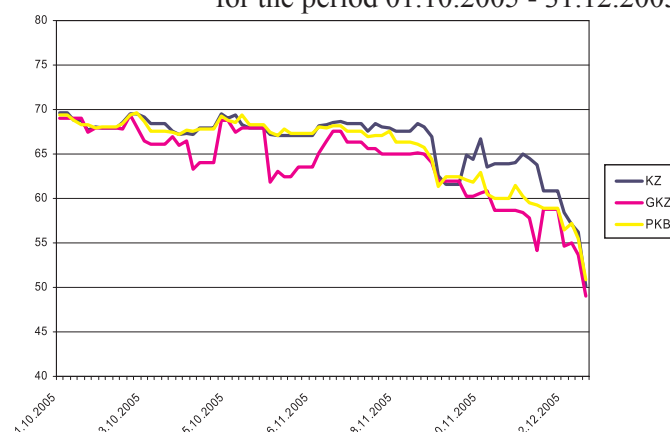
For instance, there is certain disbalance with respect to public companies from the touristic sector, such as all major Black Sear resorts. On one hand tourism is well represented on the market, but on the other hand, public tourist companies account for only about 5 per cent of the total market turnover. This low ratio is due to the fact that the holding companies, because of the method of their establishment, have a relatively high free-float and respectively high number of shareholders and free tradable shares.

## Compensatory Instruments

In the last quarter of 2005 compensatory instruments reported the biggest fall since their first registration for trading in the fall of 2002, losing more than 1/3 of their value. On one hand, there is an opinion that they have kept relatively high prices for quite a long time. Two centralized and one non-attendance auctions that had no influence on the price of compensatory instruments took place during the quarter.

On the other hand, rumors about long prepared but yet unfinished privatization deals were sufficient to maintain the price of these instruments. Not the least we shall report the fact that the direct "competitor" of the three types of tradable instruments are the housing compensatory warrants based on accumulated interest points in Central Depository accounts, which in case of a privatization, have the same rights and, therefore, will exercise a down pressure on the prices of transferable compensatory instruments.

Figure 23. Compensatory instruments price movements for the period 01.10.2005 - 31.12.2005



During the last quarter very important were the issues about the future of the capital market in the competitive European environment and the privatization of the state share in the Stock Exchange and the Central Depository AD. There are two general opinions – to seek partnership with a foreign stock exchange (association of stock exchanges) or offer the government packages to Bulgarian market participants.

Both proposals have their pros and cons. For example, the local capital market stakeholders know best what their needs are and what is necessary in order to improve the services provided by the stock exchange and the Central Depository. On the other hand, it is not clear whether they have the necessary capacity to manage these two institutions and whether they will withstand the pressure of foreign competitors. Besides, the more powerful intermediaries and banks may happen to have a competitive advantage over the smaller intermediaries that will not be able to take part in the management of institutions and this will compromise the market equality.

If foreign stock exchanges or stock exchange alliances buy the state shares, this will help the Bulgarian stock exchange and Central Depository to reach European standards from technological point of view and develop the needed preconditions for effective trading. The main problem with this option is that these two institutions may become phasing out satellites since the local issuers may prefer to finance their businesses on the bigger European markets even if traded on lower market segments. The important advantage of this option

is that the smaller Bulgarian intermediaries will have access to foreign markets.

Another option to consider is that the proposals made to date by foreign partners may aim not only at incidental enlargement of the European markets, but also at establishing favorable conditions for the purchase of other Balkan stock exchanges that have been growing in the past few years. The direct sale of the stock exchange is facing some legal obstacles. The first is in the Act on Public Offering of Securities, namely the provision that no one but the state may own more than 5 per cent of the regulated market's capital. The second obstacle is that the state can not sell its share directly to a person, since the Privatization and Post-privatization Control Act explicitly specifies the privatization methods which no longer include the option of negotiations with potential buyers.

As we already mentioned before, during the past quarter the stock exchange turnover registered an increase which is due to taxation reasons. For instance, profit from transactions with securities on the regulated market is not subject to taxation for either natural persons or legal entities. Regulations are different when it comes to reevaluation of assets of financial institutions. Therefore, at the end of the year they transfer their profitable packages to related persons and get them back at the beginning of the next year. Such transactions, although legal, do not bear tax revenues to the state; participants incur a number of unproductive expenses, and the result is net loss for the Bulgarian economy. These financial institutions are the most powerful investors on the market and, overall, predetermine its efficiency. There are no reasons to put them in a less favorable position than the other market participants.

*The key role of Russia's energy resources for the European and, in particular, for the Bulgarian economy was evident again at the end of 2005. The Government rejected Gasprom's proposal for changes in the terms and conditions of the agreement for natural gas supply to and transit through Bulgaria.*

*The steps towards electricity market liberalization seem administrative because the State Energy and Water Regulatory Commission preserves its role of a regulator determining production quotas and prices. On the international electricity market, Bulgaria became co-founder of an EU - Southeast Europe countries energy community. The common energy market established is expected to attract significant investments in energy infrastructure. The privatization procedures for the thermal power plants in Varna and Russe are again in a deadlock after the company, which was appointed winner in the two procedures, withdrew from the Varna transaction. The start of the long delayed rehabilitation and modernization of Mariza-Iztok 1 was given at the end of 2005.*

*In December, oil prices on the international markets dropped down for a while but the unfavourable political and seasonal developments caused price levels to go up above USD 60 per barrel.*

## Government Policy

In the first month of 2006, the Council of Ministers approved the law for ratification of the agreement establishing an EU – Southeast Europe countries energy community, which was signed in Athens in October 2005. Together with Bulgaria full parties to this agreement became Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, Romania and the UN caretaker administration in Kosovo. This expansion towards the Balkans made the EU energy market the biggest common energy market with more than 500 m consumers following uniform rules. Bulgaria becomes a member of the energy community at a time when the country is the biggest electricity exporter in Southeast Europe covering 45 to 100 per cent of the electricity deficit of the countries in the region and is ranked fourth as an electricity exporter in Europe. The establishment of a regional liberalized market creates favorable conditions for expansion of the potential and existing market segment of the Bulgarian electricity producers. When the common market agreement takes effect producers will be able to sign electricity supply contracts directly with companies and firms – electricity consumers from the countries in the region. The establishment of a common market will contribute to the development of the energy sector in the region and hence to the economic development of each one of the countries. Investments in energy infrastructure in the next 15 years are projected at EUR 21 b – approximately EUR 12.5 b for the rehabilitation of existing and the building of new capacities and about EUR 8.3 b for investments in transmission networks. The transmission and distribution investments in the region

will have a favourable effect on electricity export development if Bulgaria maintains its present market positions. Overall, the establishment of a common market and the attraction of investments in the energy sector in the region are expected to result in higher efficiency of the capital expenditures, which have to be made.

In the beginning of 2006, the Ministry of Economy and Energy stated its intentions to include Unit 5 and Unit 6 of Kozloduy NPP as in-kind contribution to the new Belene NPP electricity company. The in-kind contribution proposal was made by the project consultants and was supported by the previous energy minister with a view to attract higher interest from strategic investors. The ministry probably does not want the new electricity company to become a successor of the liabilities on the loans taken for modernization of Unit 5 and Unit 6 of Kozloduy NPP. Total estimated project costs vary from EUR 2 428 m to EUR 4 856 m. The deadline for submission of tender documents for the project was extended but the reason for this extension was not clear. Meanwhile experts announced that the construction of the new capacity could be fully financed by the State if NEC increased by 25 per cent the price at which it bought electricity from the nuclear power plant or if NPP's quotas for sale of electricity on the free market were increased. However, that will have effect on end-user electricity prices.

The finalization of the privatization of Varna TPP and Russe TPP is delayed again after the Russian company RAO Edinni Energiini Sistemi (United Energy Systems), which was appointed winner in Varna, withdrew from the deal. CPC did not allow the company to acquire also Russe TPP – a decision, which the Privatization Agency litigates. Negotiations with the candidate ranked second – the company CEZ, or a new tender procedure are expected for the privatization of Varna TPP. The smaller TPP – the one in Russe, will be offered again to RAO United Energy Systems or transaction with the candidate ranked second – CEZ, will be sought if the latter improves its price proposal.

Table 14. Offers submitted in April 2005 (m euro)

	Varna TPP	Russe TPP
<b>PAO UES</b>	<b>389.7</b>	<b>120.0</b>
CEZ	192.0	24.3
ENEL	150.9	4.8
PPC	131.6	-

Source: Privatization Agency

In November the Government approved the plans of World Bank's agency MIGA to issue a guarantee to the US energy company AES for its project for rehabilitation and modernization of Mariza Iztok 1. The project value is estimated at about EUR 1 b. AES will finance 30 per cent of envisaged investments and the other 70 per cent will be financed with loans from EBRD, CALYON, BNP Paribas and ING Bank.

## Electricity Market

The Bulgarian competitive electricity market continued its slow development in the last months of 2005. In the beginning of 2006, the register of commercial market participants contains 23 companies including 6 producers, 14 privileged consumers, 2 electricity traders and NEC EAD as a public supplier. Total electricity supplied to privileged consumers in the period January – December 2005 is 2 337 412 megawatt-hours.

While the threshold for participation of companies in the free market is expected to be lowered to 9 gigawatt-hours of annual consumption since July 2006, for the time present market opening seems purely administrative. The free electricity trade did not reach the planned 18 per cent and was only 8 per cent at the end of 2005. The structure of the Bulgarian energy sector is excellent in terms of the security of supplies and the dependence on world market prices but very poor as regards the establishment of a competitive Bulgarian market. The barriers to real market competition are partly because Bulgaria has production capacities with extremely wide range of electricity production prices. The wider opening of the electricity market in the next year will require significant measures to encourage producers to enter the free market. At the same time, SEWRC imposes quotas on the big producers thereby limiting their opportunities to sell directly to the privileged consumers.

For the future real opening of the market, there will be a need to seek a balance between the regulatory restrictions imposed on the participants and maintaining the market mechanism in the negotiations between the participants. A balancing electricity market is expected to develop as well. The tendency is for companies to sell the electricity surpluses on this market and when there is deficit of electricity under certain contracts to buy electricity from the balancing market.

## Natural Gas Market

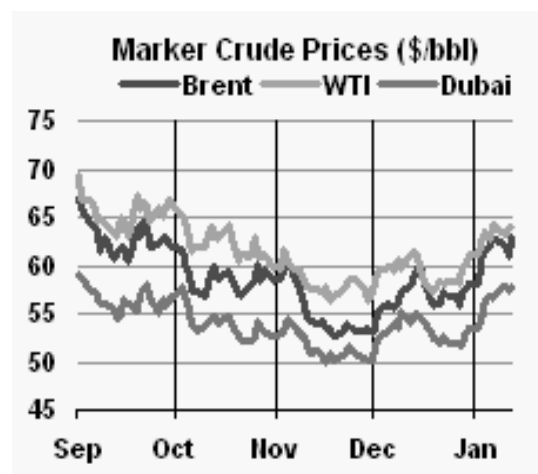
At the end of 2005, Bulgaria had to take an important decision regarding the defending of its position on the natural gas supply and transit agreement with Russia. The Government and Bulgargas rejected in a letter the proposals for renegotiation of the natural gas supply and transit prices under the long-term agreement with Russia but at the same time, they confirmed Bulgaria's interest in discussing possible future investment projects with Gasprom. The agreement with Gasprom was signed in 1998 and expires in 2010. It contains mechanisms, based on market principles, for updating gas supply prices according to international levels. Along with that, however, Bulgaria has secured the receipt of comparatively high transit charges resulting directly from the barter provision for gas transit, which allows Bulgaria to keep part of the transit quantities. This barter provision is profitable for Bulgaria for the time present as well as in periods when international market gas prices go up. Gasprom's proposal for investments in Bulgaria

still lacks particular offers and projects. Only the motivation of this proposal seems clear – investments against changing the financial parameters of natural gas supply and transit and eliminating the barter provision for transit.

The independent analysis shows that the changes in the agreement with Bulgaria which Gasprom requests in exchange of its commitments for future investments will make Bulgaria more dependable on the supply of Russian energy resources which would have a negative effect on the economic development of the country in a long perspective. On the other hand, Gasprom's proposal could undermine the development of the European project for construction of the Nabucco pipeline for transit of natural gas from Azerbaijan to Central Europe, which will go through Bulgarian territory as well. Gasprom and Gasprombank expressed also their interest in participating in the construction of Belene NPP. According to international experts, Bulgaria could be the next country for which Gasprom will change the terms and conditions of natural gas supply. Statistics also show that in the year before our accession to the EU end-user retail prices in Bulgaria are much lower compared to those in EU-25 and EU-15. Of course, the final decision will depend on the influence of Gasprom's lobby in Bulgaria.

The biggest European energy company E.ON showed interest in entering the Bulgarian natural gas market. It is interested in the gas distribution business in the regions where it has already made investments. A year ago, E.ON acquired 67 per cent of the electricity distribution companies in Varna and Gorna Oriahoviza for EUR 148 m. The President of the Management Board of E.ON stated that the company is ready to make the necessary investments for the development of the Bulgarian gas distribution network. The company is currently making also an assessment of the electricity production opportunities in Bulgaria. The entry of such investor will decrease Bulgaria's lag compared to other countries with respect to the natural gas use in the thermal energy balance.

Figure 24. Market crude oil prices

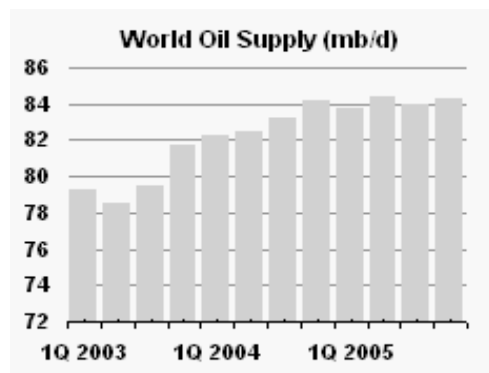




## Energy Prices

**Oil.** Seasonal factors lead again to increase of international oil prices. After some decrease in December (USD 59.45 average per barrel), in the beginning of January 2006 prices moved up again to levels of USD 64 per barrel. The basic foreign policy factors, which influenced the market at the end of the period, were the interruption of work in a couple of oil fields in Nigeria and the unstable situation in that country, as well as the uncertainty about Iran's future nuclear program. The low winter temperatures in world's regions with the highest fuel consumption increased the demand. In 2005 world oil demand increased by 1.3 per cent compared to the previous year and the increase for 2006 is projected at 2.2 per cent mainly due to the higher fuel consumption in the USA and China. In December 2005 world oil supply reached 85.0 m barrels per day.

Figure 25. World oil supply (million barrels per day)



The tendency of oil prices standing at levels about USD 60 per barrel for a longer time and the relatively stronger positions of the US dollar compared to the euro at the end of 2005 could exert external inflationary pressure on the Bulgarian economy.

## Natural Gas

Since the beginning of October the natural gas price determined by SEWRC increased by 18 per cent to BGN 276.91 per 1000 cubic meters and by another 7.15 per cent since 1 January 2006. Thus in the present quarter Bulgargas will sell gas at BGN 296.70 per cubic meter VAT excluded. The nominal increase is BGN 19.79 per 1000 cubic meters. Bulgargas requested an increase of 12.4 per cent and the price they proposed was BGN 311.21. The company justified the requested increase with the higher mazut and gas oil prices, which are up 12 per cent and 5.8 per cent respectively, as well as with the US dollar appreciation to BGN 1.60 for 1 USD. The lower natural gas price growth is achieved at the expense of decreasing the forecast gas consumption for the first quarter of 2006 by 100 m cubic meters. The same method was applied when lowering the gas price increase in October. Then SEWRC decreased natural gas consumption by 96 m cubic meters. Oil derivative prices manifest favourable trends and, therefore, natural gas

prices are not expected to increase in the second quarter of 2006.

## Electricity

SEWRC will continue to regulate electricity supplier prices after July 2007. The electricity produced by newly licensed producers will be bought at preferential prices for a period of 8 years according to the proposed amendments to the Energy Act. NEC's 2006 accounting profit is estimated at BGN 60 m. The result is almost two times higher compared to that of last year, owing to export.

In 2005 national electricity consumption increased by 3 per cent. Growth in the public sector is 5.8 per cent and household electricity consumption decreased by 3 per cent. Electricity consumption growth of 2 per cent is projected for the next year. 2006 exports are estimated at about 6 b kilowatt-hours. The decrease compared to 2005 is due to the starting rehabilitation of units in Mariza Iztok 3 TPP. They produce an average of 1.6 to 2 b kilowatt-hours per year.

In 2007 after closing unit 3 and unit 4 of Kozloduy NPP there may well be a need to import electricity if consumption increases by more than 5 per cent. The planned reconstruction of the complex Mariza-Iztok will also have effect on that. In the recent years Bulgaria covers the electricity deficit of the countries in Southeast Europe. Experts from Kozloduy NPP also expect electricity prices to increase after unit 3 and unit 4 of Kozloduy NPP are closed. The two units produce about 5 v kilowatt-hours per year.

*The transport sector witnessed changes in the management of state companies. The Ministry of Transport and Communications (MTC) announced its priorities but failed to achieve notable progress on any major concession transaction. In the past 2005, the passenger flow through the international airports in Sofia, Varna and Burgas reached five million people signalling a need to develop the passenger terminals and to increase their capacity. The completion of the new terminal of Sofia Airport was delayed again in the past quarter and so was the final decision on the concession of the two seaside airports. At the end of 2005, MTC allocated BGN 12 m from its budget for support of BDZ EAD (Bulgarian State Railways). The Government also included the financial stabilization of the company in its program. To achieve a sustainable effect, there is a need to restructure the company – an issue that still lacks a clearly formulated plan. There is also some lack of clarity about the concession of Trakia Highway. The Government announced that in 2006 it plans to build 60 km of highway roads, which however are insufficient to meet the development needs of the national road infrastructure.*

## Government Policy

The new priorities in the area of transport and communications to which the administration commits are stated in the government program of the new Cabinet:

- Improving and developing the basic infrastructure – a strategic goal laid down in the National Development Plan, 2013.
- Proactive investment program for the construction of modern infrastructure with financing from the private sector, the state budget and EU's pre-accession funds.
- Improving the management of state companies.
- Financial stabilization of BDZ EAD and the National Railway Infrastructure Company.
- Privatization of Bulgarian River Shipping Ltd.
- Privatization of Navigation Maritime Bulgare, taking account of company's importance in terms of the national interests.
- Privatization of Bulgaria Air Ltd. with focus on a transparent privatization procedure for the company
- Finalizing the concession procedure for the airports in Varna and Burgas and organizing a concession procedure for the airports in Plovdiv, Russe and Gorna Oriahoviza.
- Awarding a concession on major harbour terminals at the Danube river and the Black Sea Coast.

Government's program envisages also preparing of a National Strategy for Development of Bulgaria's Infrastructure, 2015, with clearly defined vision, objectives and priorities in connection with Bulgaria's integration in the EU. The government program places substantial focus on applying public-private partnership and concessions for the successful implementation of investment projects.

To summarize, on a conceptual level the new administration has clearly stated its priorities in the transport sector. However, previous experience from privatization and concession transactions shows that the key success factors are on the implementation level, in the specific action plans, in specifying the conditions to the bidders, organizing clear and transparent procedures protected against litigation. Unfortunately, the first months of government of the new coalition cabinet do not indicate that it will avoid mistakes made by previous governments regarding the accomplishment of privatization deals. A key factor for the successful implementation of the plans for development of the national transport infrastructure is the securing of the necessary funds for their fulfilment from the state budget and from EU's pre-accession funds.

The first 100 days in office of the minister of transport and communications led to a number of personal changes in the management of the national companies in the sector. It is difficult to detect the continuity in this respect advertised by the new minister upon his taking office. Changes covered the boards of Navigation Maritime Bulgaria (NMB), Port Complex – Russe, the boards of the ports and airports in Varna and Burgas. At the end of October, the Deputy-minister of Transport Yugel Atilla was appointed President of the Board of Directors of Sofia Airport. There were also changes in the management board of the Air Traffic Division – the Deputy-minister of Transport Vessela Gospodinova became its new president. The executive director of BDZ was also replaced at the end of October. To summarize, personal changes covered all companies and infrastructure projects expected to be privatized or given on concession within the terms of office of the present coalition cabinet.

## Air Transport

The international airports in Sofia, Varna and Burgas have serious problems in coping with the increasing passenger flow because their capacity is not sufficient for quick and efficient servicing of the passengers. Projections about the number of passengers for the next couple of years show that the current improvements will be inadequate for the increasing annual passenger flow. For example, in the first nine months of 2005 the growth in the passenger flow through Varna Airport is a little above 16 per cent. In the same period the number of passengers going through the airports in Varna and Burgas was about 1 600 000 for each airport. In the active tourist season, Varna Airport reports an arriving or departing airplane every 17 minutes, which means that a passenger is serviced every 7 seconds. In the last three months of 2005 another 90 000 passengers went through Varna Airport and about 53 000 through Burgas Airport. Thus, the passenger flow through the two seaside airports in the past year is above 3 million people. The biggest Bulgarian international airport – the one in Sofia, does not publish official data about 2005, but studies show that about 2 million passengers have passed through that airport.

Table 15. Passenger flow (thousand people)

	Sofia	Varna	Burgas	Plovdiv	G.Oriahoviza	Total
1998	1.250	549	443	52.7	0.8	2.284
1999	1.235	512	339	40.2	0.2	2.127
2000	1.128	692	398	37.7	0.8	2.255
2001	1.104	933	595	27.6	0.3	2.259
2002	1.205	1.091	767	26.6	0.2	3.090
2003	1.346	1.182	1.026	27.4	0.3	3.585
2004	1.605	1.337	1.353	37.8	0.3	4.334
January-October 2005	--	1.600	1.600	--	--	--

Source: Ministry of Transport and Communications

To satisfy the need of higher capacity the Bulgarian international airports have to build urgently new bigger passenger terminals and to improve the transport infrastructure (road network and railway transport) for transportation of passengers to and from the airports.

At the end of October, the Supreme Administrative Court in a panel of three judges pronounced against the concession of the airports in Varna and Burgas to the Danish company Copenhagen Airports. The decision was justified with omissions in the documentation submitted by the Danish company. The final decision of SAC in a panel of five judges is expected and it will not be appealable before a higher instance. The investment intentions of Copenhagen Airports are well above the initially specified minimum requirements of EUR 120 m for the two Black Sea airports. The concessionary intends to invest EUR 526 m during the 35 years of the concession, including more than EUR 100 m in the first three years for construction of a new terminal at Varna Airport and for rehabilitation of Burgas Airport. Concessionary's promises to the Government are for 30 per cent of the estimated revenues of EUR 1.2 b for the duration of the contract.

Unfortunately, the litigation of this transaction will also lead to lower investors' confidence in Government's capacity to realize successfully such transactions and to create good business environment; what is more, it will delay the urgently needed expansion and rehabilitation of the two Black Sea airports, which receive the tourist traffic in the summer season. If the growth in the tourist passenger flow in the 2006 tourist summer season preserves its rates of the past two years, the present capacity of the two airports will prove insufficient.

The project for expansion and rehabilitation of Sofia Airport is facing difficulties again. The government will negotiate extension of the deadline for putting into operation of the new passenger terminal. The deadline for placing into operation of a new runway was also extended to February 2006. In addition to the accumulated delay, the problems with the owners of plots, who blocked the construction of a road to the new terminal, continued. Nevertheless, the biggest concern regarding the

future development of Sofia Airport is the maximum capacity of the new terminal, which will receive up to 2.5 m passengers per year. Given the present growth rates, this capacity will be reached shortly after the terminal is opened.

Statistical data for the period January – August 2005 show revenues of BGN 130 m for the national carrier Bulgaria Air, much above the projected revenues of BGN 109 m for the whole 2005. In the first nine months of 2005 the number of transported passengers is 500 000 people or almost two times the number for the whole 2004, which is only 273 000 people. Despite these positive results, company's profit for the same period is only BGN 2.7 m or almost two times less compared to the same period of 2004. The main reason for that was the shocking jump of international oil prices.

The privatization of Bulgaria Air is among the most important tasks before the Government. The new privatization strategy for Bulgaria Air has to be completed by 19 January 2006 as the initially specified deadline – the end of 2005 was not observed. After its announcement, the new strategy will be put to discussion before its approval by the Parliament. The Ministry of Transport expects the process to take about three months and then the privatization of the national carrier will begin.

The Ministry of Transport is considering two privatization scenarios for the company – 1) privatization of the whole company with the State keeping a golden share in it with the right to block key decisions, or 2) privatization by a tender procedure of not less than 51 per cent of the company and privatization of the other portion (the minority share package) on the stock exchange. Different variants of the two main scenarios can be expected with respect to the rights, which the State will preserve, the requirements to the participants and the amount of the majority share. The ministry will probably accept proposals only from companies registered in Bulgaria or companies with at least 51 per cent of their capital held by local entities. This requirement is justified with the aim to preserve the opportunity for Bulgaria Air to fly to the Arab countries and the USA.

There will be no nationality problem after Bulgaria's accession to Open Sky, which the Government has scheduled for 2007. Given the negligible probability for Bulgaria Air to be sold before mid 2006 and the strong competition of big companies for the USA and Asia destinations, this condition seems rather unfavourable and limiting investors' interests. What is more, this would be the first case of discriminating foreign investors in the organization of a big privatization deal and would further deteriorate the Bulgarian business environment after the series of inconsistent decision of the executive and the judicial power, which blocked or prevented almost any of the important privatization or concession deals in the past year. These too many restricting conditions will result in lower interest of foreign carriers to participate in the procedure, hence in a lower bidding price for the company. On the other hand, an impression that

the Government tolerates the local carrier Hemus Air is created. At any case, the discrimination of foreign investors will be also criticized by the European Commission. Bulgaria recently signed with it a preliminary agreement for expansion of the single European air market to Southeast Europe.

In 2006, Bulgaria will also sign the Open Sky agreement with the EU, which will take effect from the beginning of 2007. This agreement will lead in practice to full market liberalization:

- For the air companies operating on the Bulgarian market this will mean stronger competition, in particular price competition on the part of the so-called low-cost carriers.
- The liberalized market will almost certainly decrease the market share of Bulgaria Air, which is now the leader with about 34 per cent, and that could have a negative effect on its privatization.
- On the other hand, the price competition of a larger number of carriers means more affordable air ticket prices, i.e. higher passenger flow through the Bulgarian international airports.

## Railway Transport

In the first nine months of 2005 the losses of the Bulgarian State Railways (BDZ) amount to almost BGN 26.5 m and are about BGN 8 m higher compared to the same period of 2004. The negative financial result of the company for another year in a row brought BDZ dangerously close to financial collapse because of debts towards suppliers of spare parts, car repair shops and the German Siemens. BDZ has pledged a portion of its immovable property under the contract with the German concern. The primary importance of the company for Bulgaria's transport communications and the social role it is committed to made the Government to allocate at the end of the fiscal year 2005 BGN 12 m from the 2005 budget for covering company's losses. Half of that amount was secured from over fulfilment of the revenues to the republican budget and the other half – from savings on the expenditures of the budget of the Ministry of Transport and Communications. The Competition Protection Commission approved this additional state subsidy because of the obligation to provide services of public interest assigned to BDZ. However, the use of funds collected by the State from taxes and their spending to cover the losses of loss-making state companies is a formula, which has proved its inefficiency many times and, viewed in the long run, that is against the public interest. In 2006, the budget will allocate about BGN 74 m for BDZ and BGN 60 m for the National Railroad Infrastructure Company. A possible scenario, which is being discussed, includes formation of a holding company of the two firms while preserving their financial independence. It is also possible to set up a holding company including the passenger transport, the cargo transport, the repair unit, cleaning and maintenance of the railroad infrastructure as independent companies. This in turn could be a chance for BDZ to separate the activities

generating the biggest losses and to improve the management efficiency. On the other hand, the holding structure provides higher financial security and stability, especially if guarantees on loans for modernization of company's activity are necessary. In this case, however, higher financial discipline will be required in the event of internal financing between the companies in the holding.

The railway Plovdiv – Svilengrad is also among the priorities of the Ministry of Transport regarding the development of the railroad infrastructure. Total project value amounts to about EUR 340 m, including EUR 153 m from an ISPA fund, EUR 100 m from the European Investment Bank and EUR 34 m from the state budget.

## Road Infrastructure

It is envisaged for three of the five Bulgarian highways, i.e. Trakia, Struma and Black Sea, to be completed by concessionaries. In mid December, the Ministry of Regional Development and Public Works introduced this proposal for discussion in the Council of Ministers. In its program, the Government envisages to complete by the end of its term of office Trakia Highway and to continue the construction of Struma and Mariza highways. The minister of transport expects Trakia highway to be completed by 2008-2009 despite the final decision of SAC on the concession contract.

The construction of a highway along the Black Sea coast between Burgas and Varna would have a positive effect on tourism development in the Black Sea region and will help to attract higher number of tourists with an easy and quick access from the airports in Varna and Burgas to the Black Sea resorts as well as to Bulgaria's inland regions.

The construction of Struma Highway encounters problems, which are mainly due to the relief of the terrain, which has to be conquered, whereas the start of the construction of Mariza Highway is bound to the termination of the contract with the Turkish holding Jeylan. The contract is also bound to the export of electricity from Bulgaria to Turkey and, adding to this fact the different political and corporate interests, one could not expect a decision in a short perspective.

Hemus Highway remains the most difficult to complete as for the present the Government relies for its construction on financing from EU's pre-accession, structural and cohesion funds. In the period 2007-2013, Bulgaria expects to receive from the European Union about EUR 850-900 m for improvement of its network of first-class roads. However, these funds, even if completely utilized, will not be sufficient so other sources of finance will be sought as well.

## Sea Transport

In the last few months, the privatization of Bulgarian River Shipping was also affected by litigation. This only confirmed



the last year tendency for any big privatization deal to be accompanied by delays and litigation. The Supreme Administrative Court has to come out with a final decision on the majority owner of BRS. Kaolin AD which, was initially appointed successful candidate, won the privatization competition for 70 per cent of BRS and bought the other 30 per cent on the stock exchange as early as 2004.

A tendency is noticed in the big privatization deals for the companies ranked after the first to appeal the investor appointment decision because the legal costs for this procedure are not big compared to the tender proposals. The decisive role of judicial bodies' representatives (SAC) in appointing the successful candidate in a privatization or concession procedure deteriorates the Bulgarian business environment and has a negative effect on country's attractiveness for foreign investments.

The privatization of Navigation Maritime Buglare is also on the government agenda. The previous cabinet failed to realize its plans for privatization of the company similar to the procedure prepared for BRS. In the first half of 2005, NMB reported a net profit of BGN 28.4 m.

At the end of 2005 the Bulgarian telecommunications market registered some developments. A foreign investor bought Orbitel - one of the biggest Bulgarian alternative operators; the development of the point-to-multipoint license case took an (un)expected turn. The third GSM operator – the BCT-owned Vivatel, became operational at last. The latest analysis of Bulgaria's progress in the informatization of the economic, political and social life – eBulgaria'2005, was published at the end of 2005.

**A new owner of Orbitel.** At the end of November the Hungarian telecommunications operator Magyar Telecom announced officially an agreement for the acquisition of 100 per cent of the shares in the alternative Bulgarian operator Orbitel. Magyar Telecom is a leading provider of telecommunication services in Hungary with almost 2.9 m subscribers of fixed telephone lines, 220 thousand users of broadband Internet and more than 4 m subscribers of mobile services. According to initially announced data the price of the deal is about EUR 8 m and Orbitel's management team may well continue in office after the change of ownership.

The size of the deal and the participation of a company of the rank of Deutsche Telecom is a serious indicator that the interest of foreign investors to the Bulgarian telecommunications market is increasing. Of course, the presence of big international players will be to the benefit of the Bulgarian consumers who will have the chance to choose services in a more competitive and rich telecommunications market.

Individual licenses for point-to-multipoint type telecommunication network. After the tenders for the licenses of class A and class B at which surprisingly high prices per license were reached (BGN 5 044 000 for Class A and BGN 6 172 000 for Class B), in December some companies "thought over" their proposals and withdrew from the tender they had won. To that effect was the decision taken by Orbitel and BTC which renounced the licenses of class B they had won. Consequently only two companies acquired licenses of this type – Nexcom – Bulgaria EAD and Mobiltel AD.

Orbitel's decision to refuse to buy the license is most probably due to the change of company's ownership and the respective change in the strategic goals pursued by the new owner. At the same time, BTC explained its behavior with the successful start of Vivatel and the wider range of telecommunication services which the two companies can provide to their users.

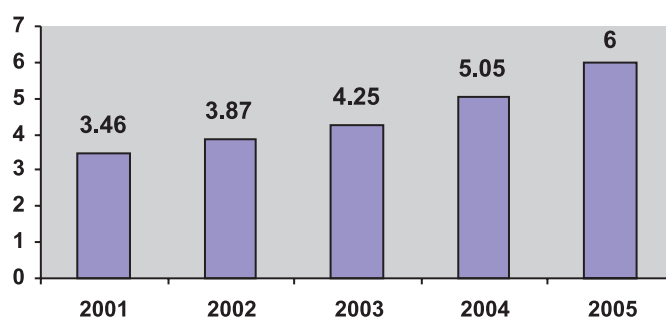
**Third GSM operator – Vivatel.** After some delay and repeated postponement the third GSM operator on the Bulgarian market – the BTC-owned Vivatel, became operational. The company started with offers for pre-paid services, the prices of which, contrary to the anticipations and consumers' attitudes, were significantly lower compared to those of the other GSM

operators. Despite that, the real competition on the mobile services market in itself caused Globul and Mobiltel to decrease in times the prices of their pre-paid services and the two operators tried to outdo each other in announcing "the lowest price". Compared to the other European countries, in Bulgaria the prices of mobile services are still high, what is more, lower prices were accompanied with changes in the tariff principles, which were definitely not to the benefit of the users.

**eBulgaria' 2005.** The latest report on Bulgaria's progress in informatization – eBulgaria' 2005, prepared by the Applied Research and Communications Fund was published in the last quarter of 2005. The report analyzes the technological support and the social and economic preparedness of households, enterprises and public institutions to use modern ICT and thus to transform their living space, work style and efficiency, to create value added and provide public services.

According to the presented data (Figure 26), in 2005 growth in the eBulgaria index remains at its 2004 value of 18.8 per cent, or two times higher compared to 2002 and 2003. Growth is due mainly to the noticeably improved affordability of new technologies, the expansion of electronic payment means and the higher demand of ICT-intensive labor, which have also contributed to higher number of computers in households and wider use of Internet by the business and the individuals.

Figure 26. Value of the eBulgaria index in the period 2001-2005.



Source: Applied Research and Communications Fund, [www.arcfund.net](http://www.arcfund.net)

The projects for improvement of the computer and network infrastructure in schools and public telecenters which the Government implemented contributed notably to index growth in the past year.

The anticipated growth in the next couple of years is connected with the infrastructure, services and content convergence processes, the development of e-Government and e-healthcare services and the improved innovation of enterprises by means of new ICT. Growth is estimated at below 10 per cent and it will be highly dependent on a number of management and political risks connected with big public projects and the work

of the institutions which guarantee the rule of law and fair competition.

**e-Municipalities.** A study of the development of the web-pages of Bulgarian municipalities was published at the end of 2005. The analysis aims to support the processes of development and implementation of public policies in the area of e-Government and e-management on local level by providing a regular comparative and problem-oriented study of municipal websites and the electronic services for the citizens provided via these sites.

The study shows that 60 per cent of the municipalities already have their own websites and all municipalities with population above 75 thousand people are present in the Internet. The main indicators employed to assess municipal sites include Internet exposure, accessibility, usability and functionality. In 2005 site assessments register improvement compared to 2004, in particular with respect to the quantity and quality of the information provided, but municipal websites are still in the early stage of the "one-stop-shop service" on the Internet.

**Software piracy.** IDC (International Data Corporation)'s analysis of the Bulgarian software industry and the abuse of copyright and use of unlicensed software was published in December. According to the analysts 10 per cent lower growth in piracy will result in opening of 7 000 new jobs, increased revenues from local industry by almost USD 130 m and will generate another 23 m US Dollars. IDC's study shows that this lower growth could contribute to higher growth in the Bulgarian IT sector by 103 per cent till 2009.

This unique analysis was conducted under an assignment by BSA (Business Software Alliance). It provides assessment of the economic effect of the IT sector in 70 countries and the possible benefit for the states which manage to lower the piracy level and to support the protection of intellectual property rights. The IT industry comprises 1.1 companies in the world and contributes to world economy almost USD 1.7 trillion per year. Ten percent lower growth in piracy can generate USD 67 b of tax revenues worldwide.

According to IDC at present the Bulgarian IT sector employs 15 000 people and contributes USD 23 m of tax revenues to the budget. The analysis shows that achieving ten percent lower growth in piracy on national level in the period 2006-2009 will contribute to:

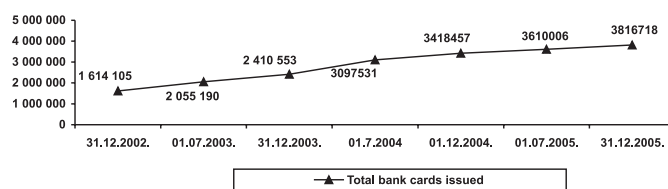
- 103 per cent growth in the IT sector, which means that in 2009 it will be assessed at USD 622 m;
- more than 2000 new high-pay jobs in the IT industry;
- higher contribution to the gross domestic product by USD 130 m;
- additional USD 23 m of tax revenues in support of the services sector.

While outlining the economic benefits, which could be achieved by stronger protection of intellectual property rights and lower growth in software piracy, the study also recommends to the countries which would like to make use of these economic benefits the following five steps:

1. to update their copyright laws and regulations, aligning them with the standards of the World Intellectual Property Organization;
2. to create strong law enforcement mechanisms corresponding to World Trade Organization requirements, including strict laws against intellectual piracy;
3. to allocate resources for solving of the problem, including to set up national teams for law enforcement in the area of intellectual property, for cross-border cooperation and for training of the officers of the police, the prosecution and the courts;
4. to improve the awareness and the public attitude of Bulgarians, and
5. to demand from the government sector to use only licensed software.

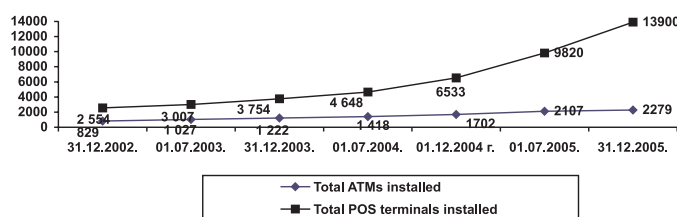
**Electronic payments.** The upward trend in the number of issued cards, operating ATMs and POS terminals continued at high levels in 2005 as well (Figures 27 and 28). Growth in the number of issued bank cards stands at about 12 per cent. This statistics does not include non-bank credit cards (Euroline and Transcard), which also expand their consumer base owing to the wide advertising campaigns and the improving user conditions. Similar is the situation with the number of ATMs and POS terminals with the latter registering two times higher growth compared to the end of 2004. Adopted electronic payment methods contribute to a decreased unofficial sector of the economy and, undoubtedly, facilitate the transaction processes.

Figure 27. Total bank cards issued, (2002 – 2005)



Source: Borica AD ([www.borica.bg](http://www.borica.bg))

Figure 28. Total ATMs and POS terminals installed (2002 – 2005)



Source: Borica AD ([www.borica.bg](http://www.borica.bg))

*According to the report of the German tour operator TUI presented at the end of 2005, Bulgaria is the most promising tourist destination in Southeast Europe. The country comes ahead of its main competitors in the region – Croatia and Montenegro. The experts point out the advantages but also the main problems of the Bulgarian tourist sector – poor infrastructure and excessive construction in the big resorts. Because of these problems Bulgaria still remains a cheap tourist destination, attracting mainly tourists with low paying capacity. Against these assessments, the upward trend in Bulgarian tourism development persisted the past year, although not at the desired and practicable pace. Special infrastructure rehabilitation and expansion continued in 2005. Along with the undeniable achievements in this respect, existing problems were reproduced and became deeper – chaotic, off-hand and environment-damaging construction. Sector's problems with finding qualified labor are more clearly outlined. There is still lack of well-targeted and properly addressed advertising of Bulgaria as a tourist destination. The other special forms of tourism which could generate higher revenues remain underdeveloped.*

## Number of Tourists and Revenues from Tourism

In the period January – November the number of foreign tourists is more than 4.5 m people, or up 5.1 per cent compared to the same period of 2004<sup>35</sup>.

Growth in the number of tourists from the EU remains higher compared to the other countries of the world. In the period January – November growth in total tourists is 5.1 per cent whereas growth in the number of tourists from EU Member States is 6.1 per cent. Growth of older EU members stands at 5.9 per cent and that of new members – at 7.2 per cent.

In terms of the geographic distribution of tourists, Germany remains the leader despite the decrease in the number of tourists in the summer of 2005. German tourists are more than 500 thousand, followed by the citizens of Greece, Macedonia, Serbia and Montenegro, Great Britain, etc.

The tendency for Bulgaria to gradually restore its positions on the markets of the countries of Central Europe continued in 2005. For example, Poland rediscovers Bulgaria which until 15 years ago was one of the main destinations for Polish tourists. According to preliminary estimates, in 2005 the number of Polish tourists in Bulgaria will be more than 100 000 people. They are attracted by the good quality – price ratio of provided services. Polish tourists prefer Bulgaria's seaside resorts, whereas in the winter they usually go to Austria and Slovenia which are more accessible geographically.

In the period January – October more than 3.5 m Bulgarian nationals traveled abroad for various purposes. Turkey, Greece,

Serbia and Montenegro, Germany and Macedonia still account for the highest number of visits.

In the first nine months of 2005 revenues from international tourism amount to EUR 1.6 b or up 9.7 per cent compared to the same period of 2004.

Bulgarians' spending on travels abroad reached EUR 600 m, or up 5.2 per cent.

Net revenues from tourism (positive balance) stand at about EUR 1 b or up 12 per cent compared to the same period of 2004. It should be noted that for the first time net revenues from tourism are more than EUR 1 b.

## Winter Season Forecasts

At the start of the winter season growth in the number of foreign tourists is projected at 10-20 per cent. The winter resorts are most attractive for Russian, British, Greek and Macedonian citizens. The number of German tourists who, in principle, prevail on the Bulgarian tourist market (more than 50 per cent of total foreign tourists) will register growth following the summer decrease.

Other projections for the growth in the number of tourists in the winter season are more moderate at about 5 per cent. This lower projected value is due to the intensive construction continuing at the start of the season (in particular in Bankso and Pamporovo).

According to experts from the Bulgarian Tourist Chamber in the winter season 2005-2006 revenues from tourism will be between EUR 40 m and EUR 45 m, against some EUR 30 m in the past winter season.

## Condition of the Special Infrastructure

Intensive construction in the big Bulgarian resorts continued in 2005. The number of beds in some Black Sea regions was actually doubled. To date Bulgaria has more than 190 thousand beds in over 1300 tourist sites.

## Winter Resorts

The dynamic development of Bulgarian winter resorts continued in the past year. This is true in particular for *Bansko*. In the past months alone investments in special infrastructure were more than EUR 50 m. The expanded material base gives grounds for experts to expect this winter more than 600 thousand tourists, or up 20 per cent compared to the previous year. Growth is expected in particular in the number of foreign tourists whereas the number of Bulgarian tourists will probably remain at last year levels.

<sup>35</sup> According to data from the National Tourism Policy Directorate, Ministry of Culture.



According to official statistical data, to date Bansko has more than 6200 beds. Two- and three-star hotels prevail. The town has also ten 4-star hotels as well as many family hotels and apartments.

Efforts to widely advertise the resort internationally are made. It is presented as a European winter resort developing at a very high pace and capable of competing with the ski resorts in Austria and Italy. The good condition of the four ski tracks with total length above 65 km, the protection nets like in the big world ski resorts, the night skiing service, etc., contribute to this image. Construction of a second gondola lift is envisaged.

Despite the enormous amount of investments and the efforts to develop the resort, one should not be mistaken that things go on wheels. Problems do exist, in particular with the infrastructure – sewerage, water supply, roads and streets. In 2006 the municipal government is ready to invest BGN 10 m to improve the infrastructure but this is only 1/5 of the necessary funds. Besides, there is lack of qualified labor knowing foreign languages and capable of providing quality services to the tourists.

The project for modernization of *Borovez* is starting in January 2006. Total project value is above BGN 300 m. The project has three phases (upper, mid and low *Borovez*); completion of phase 1 is scheduled for 2007. Hotels and family houses as well as new ski tracks and facilities will be built in upper *Borovez*.

Project implementation will result in two times higher booking of the tourist base in *Borovez*, hence to the opening of 10 thousand new jobs.

In the present winter season growth in the number of foreign tourists is projected at 15-20 per cent, with Great Britain, the Balkan and the Scandinavian countries, Russia accounting for the highest number of guests. Bulgarian tourists are expected as well. To date *Borovez* has about 6000 beds in 40 categorized hotels and villas. Total ski facilities' capacity is about 10 thousand people per hour.

#### *Pamporovo*

Substantial investments are made in *Pamporovo* as well. *Persenk Hotel* is being modernized. Bulgarian companies in the region make efforts to attract investments from Western Europe and Russia. The focus is on the region around *Smoljan* where notable improvement of the tourist infrastructure is expected – building new gondola, chair and tow lifts, etc.

#### **Black Sea Resorts**

The special infrastructure remains concentrated mainly in the big resort complexes along the Black Sea coast.

To date *Golden Sands* have 32 thousand beds; experts project their number to reach 50 thousand in the next years. For the successful development of the resort there is a need to improve the transport infrastructure, in particular the panoramic road and *Varna Airport*. Problems arise also from the insufficient capacity of the water treatment plant in the region. There is lack of new plant designs and the capacity of the present one has long been exhausted.

According to experts and tourists, *Albena* remains the best integrated and developed Bulgarian resort. It boasts with moderate construction, large green areas and spaces between the hotels. The resort is excellent for tourists who are fond of peace and tranquility. Efforts are made for an earlier and longer season. Notable is the higher inflow of Bulgarians for which credit goes to the diversified offers, in particular “all inclusive”, “at last minute” etc. Such offers are very attractive for the Bulgarian tourists.

Many towns and villages north of *Varna* provide good opportunities which are still underutilized. Construction of new hotels with about 15 thousand beds is anticipated in *Kranevo* in the next two years. Before the anticipated expansion of beds, however, there is a need to reconstruct and expand the existing infrastructure.

*Kavarna* also emerges as a town with good investment opportunities and development perspectives, including as a cultural center, provided that the pace of construction is kept moderate.

*Shkorpilovzi* can become an attractive region as well. In the summer of 2005 the municipal government announced an ambitious project for the construction of a resort area with 25-30 thousand beds. The region boasts with mineral waters, which will allow using the base all year round and developing spa tourism. Construction of a yacht port and a golf terrain is envisaged, as well as of an “inner sea” – a huge water pond, which will take water from the sea.

According to NSI's data, in the past year the number of tourists who visited *Sunny Beach* increased two times compared to 2001. Season 2005 started with notably expanded material base – more than 42 thousand beds in 145 hotels in the East zone alone. Intensive construction in the West zone continues. However the resort has serious problems because of the insufficient capacity of the general infrastructure – there is a need to build a water treatment plant, water supply and sewerage facilities, electricity distribution networks and roads. The villages of *Ravda* and *St. Vlas* develop rapidly as well. In practice these two resorts and *Sunny Beach* have merged into a single whole.

As the capacities for new construction in *Sunny Beach* are gradually exhausted, investors focus on the regions south of

Burgas. In a mid-term perspective the resorts south of Burgas will become more attractive. Low construction prevails; higher green area standards are applied. Towns like Tsarevo, Sozopol, and Primorsko have great potential and strive to attract tourists with new construction as well as with different cultural, folklore and music events.

There is no doubt that the special infrastructure along the Black Sea coast is being expanded and rehabilitated. However, problems are appearing and have to be solved in order for tourism to develop as a modern competitive sector internationally.

To date about 80 per cent of the special infrastructure is concentrated in 20 municipalities covering only 9 per cent of Bulgaria's territory. Big resort complexes are beginning to look like towns where one can hardly find conditions for recreation and rest.

Not accidentally foreign experts and diplomats (for example the ambassador of Switzerland) also point out that the excessive construction along the Black Sea coast and in the mountain resorts is unacceptable and detrimental to the environment. Bulgaria must make efforts to overcome this problem. Environment protection and preserving the ecological balance should be a priority in the implementation of tourism projects. The construction of ski tracks in Bansko and Pamporovo and the future implementation of the Super Borovez project also generate concerns.

Inland special infrastructure is developing as well – owing to the efforts of many local governments to attract funds from different programs and to public-private partnerships the base in regions like Tryavna, Koprivshtitsa, Melnik, Troyan, Gabrovo, is gradually rehabilitated.

## General Infrastructure

According to Bulgarian and foreign experts, at present the main barrier to Bulgarian tourism sector development is the condition of the road infrastructure and the insufficient capacity of the Bulgarian airports, in particular those in Varna and Burgas. The reconstruction of the airports in Varna and Burgas was delayed because the concession award procedure won by the international airport operator Copenhagen Airports was appealed and that will have serious negative effect. Prompt measures are needed to improve the capacity of the two airports. The Danish concern announced that in the first year alone they are ready to invest EUR 25 m for airports' expansion and total EUR 140 m in the next 3-4 years of the concession period.

This calls for the Supreme Administrative Court, before which the other participants in the procedure appealed the airports concession decision, to come out with a decision soon.

Improving the road infrastructure is a priority for the drawdown of money from European funds which will definitely contribute to tourism development.

Problems with the water supply and water treatment infrastructure in big resorts persist. The State and the local authorities do play a significant role in infrastructure development. However the partnership with private entrepreneurs should not be neglected as it can be very beneficial.

## Human Resources

In the last few years the labor force in many economic sectors including tourism is losing quality.

At present the Bulgarian universities train about 3 thousand students who could become managers in tourism. However, according to experts the sector needs almost twice higher number of qualified personnel. Many hotels and tourist agencies are still managed by people who do not have the necessary qualification. Tourism training has many defects: insufficient number of experts, lack of correspondence with business requirements, lack of practical focus which makes it necessary to organize additional on-the-job training, etc.

Some universities successfully cope with these problems. Practical orientation programs are developed and implemented, often with foreign experts' assistance. To date 15 Bulgarian higher education institutions provide training for the needs of tourism. The service personnel are educated in the secondary schools and colleges with focus on tourism. Very popular is Albena International College which offers a couple of international programs. Work is going on in partnership with French, Dutch and other experts; practice training in Great Britain, the USA, etc. is organized.

The intensive special infrastructure development definitely calls for labor market restructuring and for increasing the number of qualified personnel in tourism. Business' involvement in the training of specialists remains negligible. There is also lack of will and readiness to accept students on probation in private companies, to provide education grants, etc. The fact that personnel training and qualification account for only 2 per cent of private companies' costs shows that the importance of human resources is neglected. There is a need to improve business' involvement and the partnership with the State.

## Characteristics of the Bulgarian Tourist Product

The Bulgarian tourist product develops and improves. However, despite its great potential, it is still characterized by seasonality, irregularity and lack of proper focus. Cheap summer holiday packages and, to a lesser extent, winter ski-packages, prevail. The highly promising special forms of tourism, which could

better attract tourists with higher purchasing capacity, remain underdeveloped.

Bulgaria has excellent potential for development of cultural tourism. Unfortunately achievements in this area are still small because of the lack of: special branch organization of cultural tourism, dialogue between the people engaged in culture and the hoteliers and restaurateurs, partnership between the central and local governments and the entrepreneurs. There is a need of concerted efforts of all people interested in the development of cultural tourism. Besides, there are no roads to many interesting and important cultural and historical monuments<sup>36</sup>; the quality of advertising in cultural tourism and, overall, in alternative tourism is very low.

Bulgaria has good potential to develop *congress tourism*. Data show, however, that in the past year only 10 international conferences were organized in Bulgaria and in this special tourism form the country lags compared to Central and East European states. Statistics reveals that the number of conferences organized in one year in smaller countries like Croatia and Slovenia is three times higher compared to Bulgaria. 80 conferences were organized in Hungary, 60 in Poland, etc.

Overall, revenues from this form of tourism are per times higher compared to revenues from local tourism. Bulgaria incurs high losses from underused congress tourism opportunities. A special organization with the ambitious task to present Bulgaria as an attractive place for congress and business tourism has been set up. Advertising will target traditional markets like Great Britain and the USA but also potential new partners from China, Japan, the Middle East countries, etc.

*Spa tourism* is also a sector where Bulgaria has great potential. In the past years investors refocused their interest from seaside and mountain resorts to spa centers and Bulgaria provides excellent conditions for the development of such centers – abundance of mineral springs with healing water. Not accidentally the spa complex in Katarino was declared the 2005 best holiday complex.

Health prophylactics and wellness care are very important in the modern world. Building spa and wellness centers, in particular in resorts providing other recreation and rest opportunities as well (for example ski and sea tourism), could improve the overall development of the towns and villages.

There are many good practices in this respect – Pomorie, Velingrad, Devin, etc. prove that this is a successful form of development of Bulgarian tourism. However, to fully realize the existing potential, there is a need to solve a number of problems – develop a national strategy for Bulgarian mineral

waters, a law on the structure and development of spa resorts, an ordinance on their categorization, specify optimum resort capacity, etc.

*Hunting tourism* has great potential as well. Bulgaria has 56 elite game reserves but annual revenues from this form of tourism amount to about EUR 2 m while Hungary for example has only 6 game reserves and EUR 300 m of revenues from hunting tourism.

These are just a few examples of Bulgaria's enormous potential for a maximum diversified tourist product. The latter can be made attractive to different categories of tourists and developed all year round in all Bulgarian regions.

### **Government Policy in Tourism. Changes in the Legislative Framework**

In 2005 government policy outlines a couple of *key priorities* – encouraging local and regional initiative and promoting public-private partnerships. These are expected to contribute towards decentralization by horizontal cooperation of the State, local governments, branch organizations and the private sector. That will improve the dynamics of regional development and will create new jobs at municipal level.

The cultural-and-tourist information centers in Varna, Vidin, Plovdiv, Veliko Turnovo, and Russe were set up with that end in view.

2005 did not bring any National Tourism Development Strategy. Such document will clarify the priorities of Bulgarian tourism, outline the characteristics of the tourist product and create better conditions for improving its competitiveness.

Problems with the efficient presentation of Bulgaria as a tourist destination persist. In that connection at the end of 2005 development of *Advertising Strategy for Bulgaria* was recommended at a meeting of the Council for Economic Growth. It will contribute for increasing the inflow of investments and tourists to Bulgaria. In fact, a comprehensive marketing strategy specifying the sectors where Bulgaria has undeniable advantages compared to the other Balkan countries is proposed.

In November 2005, the Parliament passed on second reading *amendments to the Act on Tourism*. They envisage equal prices of tourist services on Bulgarian territory for Bulgarians and foreigners. This decision of the National Assembly was called for by the EU requirements for equal standards regardless of individuals' nationality. However the people working in the sector are not unanimous in their attitude to the decision. Many experts believe that it will result in higher prices, making Bulgarian resorts unaffordable for many Bulgarians. The better variant is to make this change after Bulgaria's accession to the

<sup>36</sup> At the end of 2005, funds from PHARE for the construction of roads to Perperikon – a place of interest connected with the Bulgarian history and culture, have been declared.

EU. Of course, it is possible even now to implement a flexible price policy which does not prevent Bulgarians from spending their holiday in the country. Besides, in many cases foreigners pay less than the Bulgarians for their holidays because they make use of many promotional offers at reduced prices.

Other amendments to the Act on Tourism envisage for making tourist huts and the catering establishments to them independent tourist sites with their own categorization symbols – the respective number of edelweisses.

The Trade and Consumer Protection Commission will provide follow-up control under the Act on Tourism whereas the mayors of the municipalities will carry out preliminary control of the sites they have categorized.

An important amendment to the Act on Tourism provides for the set up of *Tourism Agency* at CoM to implement the government policy in the field. The agency will be a second-level spending unit for budgetary funds at the Ministry of Economy and Energy. The president of the agency will: provide organization and control of tourism product's quality, register the activities of tour operators and tour agents and the categorization of tourist sites, and provide guidance of the National Tourism Council.

To date, however, the Tourism Agency still does not have executive director appointed which has a negative effect on the solving of important problems concerning the categorization of sites, organization of advertising abroad, participation in international expositions, etc.



*The past year was not a good one for the agriculture sector. The heavy rains in summer damaged (and, in many places, even destroyed) part of the crop. This served to strengthen the trend for the contracting share of this sector in national economy. Efforts were mostly focused on the preparation for the country's accession to the EU. On the one hand, this meant establishing the necessary organization for application of the acquis and tackling the delay (as registered in the Monitoring Report) in the setting up of a Paying and Intervention Agency and the Integrated Administration and Control System through which EU funds will be disbursed after 2007. On the other hand, a major challenge continues to be the need to change the structure of agriculture, which is still dominated by small holdings that should merge and diversify their activity. The European Commission's recommendations also discussed the need to improve the coordination of efforts on trade mechanisms and common market organizations for various agricultural products, strengthen veterinary control on the domestic market and establish the necessary veterinary border inspection posts.*

## Share in GDP and GVA

The heavy rains in summer and the thousands of hectares of flooded land led to a drop of 6.6 per cent for the agrarian sector in Q3 - a time of year of traditionally strong performance for agriculture - and a 5.5 per cent drop for the first nine months of the year. Plant-growing was worst affected (especially viticulture), but animal breeding also suffered a serious loss. All of this led to a decline in the share of agriculture in national GDP and GVA to 10 and 8.6 per cent, respectively, for the first nine months of the year (relative to 11.6 and 10 per cent for the corresponding period of 2004). By our estimates, the share of the agricultural sector in GDP will not exceed 9 percent, and its share in GVA will hardly go above the 8 per cent mark for 2005 as a whole. On the other hand, the value of exported agricultural produce in 2005 exceeded the 2004 levels by about 20 per cent and topped EUR 1 billion. The exports of wheat alone registered a 60 per cent increase while for dairy products the increase was 13 per cent.

## Crop Condition

3.45 m tons of wheat was produced in 2005 which exceeds the usual consumption level of about 2.4 m tons. The surplus of 1 m tons and the large quantities in stock from the previous year's harvest allowed for increased exports. The low purchase prices blocked the market early in the season and the intervention of the Agriculture Fund is now expected to boost trade. The wheat harvested is not of high quality and production standards are not aligned with international requirements; this affects price levels in the international market. The impossibility to sell faster a larger portion of the crop forced farmers to sow less in autumn (in 2004, wheat crops covered 11 million hectares while in 2005 the wheat crops covered only about 9 m hectares).

The year was particularly unfavorable for vine-growing and wine-making. The low temperatures in February destroyed about 30 per cent of the expected harvest. This affected not only the quantity of the yield but also the expenditures made to recover part of the plants or grub others. The heavy rains in spring and summer impeded pollination and effective plant protection and prevented the accumulation of sufficient sugar content and the ripening of grapes. As a result of all this, the grape yield turned out insufficient both in terms of quantity and quality to ensure a good year for wine-making. Some wine-producers were forced to restructure or (temporarily, for the time being) suspend the operation of some production lines.

## Land Market

A major problem for agriculture remains the fact that farming land is parceled out which prevents the use of farming machinery and the introduction of new technology. The state made the first steps towards establishing a single real property register and cadastral maps.

Private businesses turned out to be much more resourceful and organized - within the space of just a few months, 3 investment companies were established to purchase farming land. With their support, the concentration of land property in the country made a step forward. The land purchased by these funds exceeds 50 thousand hectares; this process is expected to gain pace in 2006. This will have a positive effect both on the land market and on the development of land tenancy relations and the effectiveness of agriculture as a whole. The new owners - the investment companies, are in a position to offer better land tenancy terms, exercise control on the way land is managed and assist in providing its more efficient use. The concentration of land property will also enable the more successful absorption of EU funds. The combination of these factors is expected to make the land market more liquid and prices will go up considerably (by 70-80 per cent), because consolidated land parcels provide a much greater profitability. It must be however noted that the concentration of ownership does not automatically lead to the consolidation of parcels. This will be a much slower process.

## Meeting EU Membership Commitments

*Land Consolidation.* In 2005, little progress was made towards meeting the commitments taken as part of the country's pre-accession negotiations. To overcome the problem with fragmented farming land and in order to facilitate the process of land consolidation, the ortho-photo imaging of parcels was started as part of establishing the Land Parcel Identification System and the overall Integrated Administration and Control System (IACS). The ortho-coverage procedure is on track and it is expected that by the middle of 2006 the country's digitalized map will be completed.

*Paying Agency.* A draft Paying Agency Act was prepared; it lays down the rules for the setting up and operation of the Agency and the Integrated Administration and Control System, as well as the implementation of the Single Area Payment Scheme. Without this law, no financial resources can be used from the EU's agriculture funds. The Paying Agency will be in charge of making decisions on the schemes and support measures; it will disburse payments and, if necessary, intervene on the market. Under the Single Area Payment Scheme, farmers registered in the Integrated Administration and Control System will receive direct payments depending on the area they utilize. The Paying Agency is expected to be operational on a trial basis as early as 2006. The new Act will serve as legal grounds for the disbursement of negotiated EU financial resources in support of farming and rural development. Its adoption will be another step forward in the country's preparation for EU membership.

*Milk Board.* The upgrading in one of the sectors of agriculture – the milk sector, requires the establishment of a National Milk Board and 8 regional boards for the administration of milk quotas to assist in the fair pricing and the “own checks” principle in quality control; these units will also assist in the preparation of regional strategies for the development of milk-producing and milk-processing establishments. In 2005, the National Milk Board and 4 regional ones were set up; a timetable was drawn up on the introduction of the milk quota system. Bulgaria and the European Commission agreed on the pilot introduction of the quota allocation scheme from 1 April 2006. All of this helped stabilize and consolidate existing cattle-breeding farms and those with 10 or more milk-producing animals now produce over 35 per cent of milk.

*HACCP.* The food & beverage industry took steps to guarantee the production and placing on the market of high-quality, safe and healthy products and foodstuffs. A priority in government policy in this respect is to assist and control the upgrading of food businesses by introducing and operating safety systems such as HACCP and good manufacturing and hygiene practices. A national food quality and safety authority will be established in compliance with the food *acquis*. The current food quality control and safety system in the country is not functioning properly. There are proposals for the existing National Food Safety Council to be upgraded to an independent national authority regulated by a dedicated law.

*Veterinary control.* The 10 new ordinances adopted late in the year meet the country's pre-accession commitments and lay down the rules for the prevention, control, and eradication of various animal diseases, as well as animal welfare requirements. Some of these ordinances are implementing legislation under the recently adopted Veterinary Activity Act. As part of the implementation of a project under the PHARE Program for improvement of border veterinary control, the construction of three (out of a total of eight) border inspections for veterinary control and quarantine has been started. These will be located

at the Varna-West and Bourgas ports, and also at the Border Crossing Check-Point at Kalotina, which will service the EU's future external borders. The goal is for the border veterinary posts to operate in full compliance with European requirements in the area of trade in live animals and animal products and perform strict monitoring and control on the traffic of such products through the future external EU border.

*Direct Payments.* MAF approved a draft document on the conditions that farmers will have to satisfy in order to be eligible for subsidies following the country's EU accession and the introduction of the Single Area Payment Scheme. The size of the eligible arable area varies depending on the type of utilization: registered farmers must work at least 1 decare of arable crops; for farmers producing vegetables, grapes, tobacco, potatoes and perennials, the minimum is 5 decares, and for grain it is 10 decares. The size of the utilized area will be proven also through the ortho-imagery system.

## State Fund for Agriculture

Grain producers were paid BGN 10 m for the autumn campaign in the form of subsidy from the State Fund for Agriculture. The grant was planned to be sufficient for 5 million decares. In order to satisfy the grant applications filed by grain producers and subsidize the sowing of the over 5.6 m decares declared, the fund decided to re-allocate another BGN 2.8 m from undisbursed funds under two other grant schemes. The loans and subsidies provided by the fund will be used to purchase high-quality seeds worth about BGN 22 m, and will ensure the sowing of about 4.5 m decares of wheat. A grant of BGN 9 m for the purchase of mineral fertilizers during the sowing season will enable the application of fertilizers before sowing on 3.6 m. decares.

Pursuant to a decision of the Council of Ministers, the intervention purchasing of wheat by the state in the amount of 150 thousand tons will start in early 2006, at an initial price of BGN 175 per ton for a minimum consignment of 100 tons. Acting as the future intervention agency under EU rules, the State Fund for Agriculture announced a tender procedure at the end of December for the selection of licensed public warehouses and grainstores for the storage of wheat purchased as part of the intervention. The warehouses must be located in regions in the country where grain production exceeds consumption and meet the capacity requirements of 6 thousand tons; further, they should have the capacity to receive and handle 50 tons per hour, have the equipment necessary to clean and ventilate the grain, and have test laboratories and the appropriate transport infrastructure.

## SAPARD Program

The SAPARD Program and its successful implementation continues to be a focus of special attention by government

administration. Working disbursement mechanisms, administrative capacity building and efficient relationships between authorities responsible for the program are being established as part of the effort. The experience obtained as part of the implementation of this program will be very useful in the successful management of future European financial instruments.

At the end of December, the Board of Managers of the Agriculture Fund (which is accredited as the Paying Agency for SAPARD) made a decision to reallocate undisbursed resources under individual measures in the financial memoranda for 2002, 2003 and 2004, in order to ensure the better absorption of funds in the farmers' best interest. This means that about EUR 180 m can be absorbed before program implementation is completed, this accounts for over 40 per cent of the total amount of financial assistance under the program. Most of this money (EUR 22 m) will be used for investments in farms. The undisbursed funds from measures planning the establishment of farmers' organizations, irrigation resources management and technical assistance will be re-allocated to the processing and marketing of agricultural products, upgrading of villages, professional qualification etc. The resources available for the measures "Renovation and Development of Villages" (EUR 8.5 m) and "Development of Rural Infrastructure" will be increased significantly because all funds undisbursed to the present were transferred to the 2006 budget. EUR 5.6 m was earmarked for the development of organic farming; these were re-channeled from the measure "Development of Environmentally Friendly Agricultural Practices and Activities" for the past 3 years. The proposed changes in the SAPARD Program intended to respond to the country's actual needs are expected to be approved by the European Commission in early 2006.

The remaining funds under the program will be used to finance both new projects and those that were suspended in the past 2 years because of the depleted resources for individual measures. MAF data shows that a total of 1,921 contracts have been concluded so far (1200 of which are fully completed) and BGN 747 m have been disbursed (75 per cent from EU funding and 25 per cent from national co-financing schemes). The funding agreed with the EU for the first three years of Bulgaria's membership is in the amount of EUR 733 m. The National Rural Development Plan envisages for 41 per cent of this money to be used for improving the competitiveness of agricultural holdings; 30 per cent will go for natural resources conservation, 25 per cent for improving living conditions in rural areas, and 4 per cent will be spent on technical assistance in the sector.

The issue with the disbursement of funds for forestation and forest roads was also resolved following the Government's decision that the national budget will finance VAT payments. This will allow for the implementation of 20 municipal projects put "on hold" due to municipalities' lack of resources to cover the VAT costs. The municipalities will be also made exempt from

duty tax on the purchase of equipment, machines and software intended for the planting, management and maintenance of forest areas, tree nurseries etc. The funds under the forestation measure are expected to be used for the planting of 15 thousand decare of new forests in heavily eroded lands and wasteland.

*At the end of 2005, a consensus was reached on the European Union budget framework for 2007-2013. Over this period, Bulgaria will receive EUR 11.1 b, which is EUR 144 m more than the initially proposed amount. The resources Bulgaria will receive from EU pre-accession and structural funds are the largest when calculated on a per-capita basis as compared to all new Member-States. These resources will be channeled for rural development and support to farmers, the construction of roads, improving the competitiveness of the economy and enterprises etc. The successful absorption of European funds requires the establishment of institutional and administrative capacity. Some of the most important strategic and planning documents in regional policy were adopted in 2005. These are: the 2007-2013 National Development Plan with its operational programs, and the National Regional Development Strategy. A major development was the elaboration of regional plans setting the goals and priorities in the development of planning regions in the country. Clustering, a relatively new approach in the development of regions in Bulgaria continued in 2005. This is an efficient tool for regional development, economic growth and achieving a balance and cohesion between regions. Over the past years a number of good practices have been introduced in local government. Serious attention is given to public-private partnerships in developing strategic and planning documents for municipalities and in implementing specific projects.*

## Preparation of Strategic and Programmatic Documents

The past year 2005 was groundbreaking in terms of Bulgaria's preparation for full EU membership and the building of capacity for absorption of European funds. An event of outstanding significance which also gave a boost to progress in this field was the official signing of the Treaty on the Accession of Bulgaria and Romania to the EU that took place on 25 April 2005.

Active efforts are continuing on the drafting of strategic and programmatic documents that will allow the country to conduct a regional policy in line with EU requirements.

## National Development Plan 2007-2013 cum Operational Programs

Elaborating the documents under the plan is a difficult process which requires good coordination between institutions, as well as wide public debate on the purposes and priorities in the use of funds involving the representatives of non-governmental organizations, the business community and local administrations.

It was these principles exactly that were applied in the preparation of the *National Development Plan 2007-2013*<sup>37</sup> (NDP) and its 6 operational programs. This is one of the most

important documents on the basis of which EU structural and cohesion funds will be allocated and absorbed under project-based principles.

Last year, the 6 operational programs under the plan were drawn up; these outline the key aspects of the future use of the funds. These programs cover the following areas: competitiveness, human resources, agriculture and rural areas, environment protection, transport infrastructure and regional development.

The method of drafting the operational programs involved first the development of the analytical parts to programs - the socio-economic and SWOT<sup>38</sup> analysis. This was finalized in early 2005 with the contribution of experts from ministries and non-governmental organizations.

The next steps of the work on the operational programs included:

- establishing the priorities and implementation measures based on the strengths, weaknesses, opportunities and threats identified in the analysis;
- coordination of the measures under separate programs to avoid the overlapping of proposals.

This established the framework within which the specific development projects will be drafted. This stage was also largely finalized and this allowed the government to adopt the NDP at the end of December, 2005.

An important aspect in the development of the NDP and its operational programs was the holding of discussions involving all working groups and representatives of the general public. The purpose was to comment on the documents drafted jointly by each group, to find the "crossing points" between them to avoid any overlapping of planned actions which could create funding problems later. Several forums were held in the course of the year at which consensus was achieved on the key aspects in the country's development, and maximum public support was sought.

## National Regional Development Strategy

An important step towards the successful implementation of regional policy was the *National Regional Development Strategy* adopted by the Council of Ministers in April 2005. This is one of the country's key strategic documents needed for the implementation of regional policy. The Strategy covers the 2005-2015 period. The major tools for regional development are the Cohesion and Structural Funds of the EU and the active public-private partnership in their absorption.

The document sets out the goals and priorities of regional policy; it will be used as the foundation to develop regional development strategies, municipal and planning-region development plan,

<sup>37</sup> The socio-economic analysis accompanying the plan was developed and submitted in 2004 by the Economic Analyses and Prognosis Agency.

<sup>38</sup> Outlining the strengths, weaknesses, opportunities and threats in given area.



as well as the National Regional Development Operational Program.

The Strategy was drafted in line with the requirements of European cohesion policy aiming to close the gaps between regions, and achieve economic, social and territorial cohesion. These basic principles also lay down the *major goal* of the Bulgarian development strategy, namely: to achieve the sustainable and balanced development of planning regions. This includes: the construction of European transport corridors passing through Bulgaria's territory; increase in direct foreign investment; development of clusters as an investment factor in certain regions and sectors; active use of pre-accession and structural funds and the EU Cohesion Fund towards the development of regional infrastructure and integration of cross-border regions.

The Strategy contains analysis of Bulgarian municipalities' *capacity for joint work*, search of common solutions and partnerships. It notes the fact that municipalities do not make use to a sufficient degree of the opportunities for joint project development and uniting efforts and resources available to them. Nearly 2/3 of municipalities have never worked in partnership with other municipalities and as few as about 1/3 have taken part in any sort of co-operation, mostly in the form of consultations with other municipalities. This limited capacity for partnership poses serious threats to the successful absorption of European funds and requires teamwork training efforts for local government officials. Small municipalities experience the most pressing need for training as such partnerships in solving economic and social issues is of enormous significance to them.

The Strategy states that regional development projects will be implemented on the basis, among others, of *public-private partnerships*. This is the mechanism intended to boost the efficient absorption of funds.

A Financial Plan to the National Regional Development Strategy was also adopted. The funds required for the implementation of the Strategy are estimated at BGN 8 b. Its successful implementation will be the foundation of EU co-financing, mostly from the European Regional Development Fund. National co-financing will be in the amount of 25 per cent of the total size of planned resources. The remaining 75 per cent will be provided from the EU budget. This means that about BGN 1.9 b will be earmarked from the national budget.

The Strategy also sets out the *quantitative indicators*, on the basis of which the performance on Strategy goals will be evaluated: reducing the rate at which Bulgarian regions fall behind the average EU levels, closing the gaps at the municipality and region level and development of territorial co-operation. *The key indicators* are:

- increase in the Gross Domestic Product per capita from 29 per cent in 2003 to over 40 per cent of EU regions average;
- increase the employment rate from 52.5 per cent in 2003 Year to over 65 per cent in 2015;
- provide access to broadband communications to at least 1/3 of the population.

## Regional Development Plans (NUTS 2 level)

In 2005, work on the drawing up of the 6 *regional development plans* continued and was largely finalized.

The plans were drafted in line with the requirements of the Regional Development Act<sup>39</sup>. The plans lay down the objectives and priorities in the development of planning regions as a component of the country's overall development. The indicative financial frameworks are an integral part of them.

The plans were drafted according to the provisions of the National Regional Development Strategy. They meet the key EU regional policy requirements, which include:

- consistency and compliance with the EU regulations and criteria;
- long-term objectives and priorities;
- short-term implementation programs and an indicative financial timeframe outlining concrete periods;
- an option for further development in a specific future period when the implementation environment might be changed.

*The major principles* in developing the plans are in compliance with the EU regional development policy. These principles include: coherence; concentration of resources; partnership; openness and transparency; complementarity of funding; coordination of activities; coordination of policies, instruments and activities; compliance with the laws and regulations in the country and the EU regulations.

The plans also contain detailed and in-depth analyses of the economic, social and environmental development of the planning regions.

These documents also outline the priorities for regional development in the social, the economic and environmental sphere for the period 2007-2013. About EUR 11-12 b will be invested for their implementation, with 2/3 of the resources coming from EU regional development funds, and the remaining portion financed by the state.

*The structure* of the plans includes the establishment of a vision on the region's development and the main strategic goal. To achieve this goal, the document lists the strategic objectives

<sup>39</sup> The Regional Development Act was adopted by the National Assembly in February 2004 promulgated in OG, No 14 of 20 February, 2004, amended OG, No 32 of 2005.

and then the priorities in the development of each of the 6 regions, and the implementation measures.

The plans are accompanied by an indicative financial schedule reflecting the overall needs assessment and available financial resources that can be used to implement the regional policy.

The Regional Development Plans will be the foundation of the National Operational Program for Regional Development.

The development plans for the 6 planning regions were adopted by the Council of Ministers at the end of 2005.

Also at the end of the year, the materials prepared to present the 6 Bulgarian planning regions to the EU were discussed and approved<sup>40</sup>. The materials include geographic maps on which the country's cultural and historical landmarks are shown, and advertising brochures. These will be distributed at EU institutions, Bulgarian embassies abroad, private companies.

The very process of preparing and efficiently implementing the plans requires wide public support and active *public-private partnership*. The plans are available on the Ministry of Regional Development and Public Works website and are subject of wide public discussions.

Work continues on drafting the regional development and design strategies and schemes (NUTS 3 level) and of municipal development plans (NUTS 4 level 4). Proposals included in the plans must comply with the key priorities of municipalities and the regional development strategies. Within the measures indicated in the plans, projects will be selected for support and implementation.

### **Raising the Awareness Level of Local Authorities, Businesses and Citizens on the Goals of Regional Policy**

In parallel with the drafting of planning documents, an important aspect for the successful European integration is to raise the awareness of local authorities, businesses and citizens on the goals of regional policy, opportunities provided by the structural funds and the priorities of regional development plans. These issues precisely were the subject of discussions at a series of seminars organized in September and October 2005 by the European Commission's Delegation to Sofia. Commission experts have defined the fundamental issues in drafting and implementing regional policy as follows:

- limited exchange of information;
- inadequate knowledge, experience and motivation impeding the process of forming regional policy.

To address these issues, during seminars held in the 6 planning regions the subject of discussion was their own development potential and the role to be played by European funds.

### **Changes in the Regulatory Framework on Regional Development**

In April 2005, the National Assembly adopted on second reading *amendments to the Regional Development Act* in its part on establishing the target impact areas.

Following these amendments, the areas are now divided into: areas of economic growth; areas of industrial decline; underdeveloped areas - border, rural, mountainous. The classification criteria are stipulated in the Regional Development Act<sup>41</sup> and they are as follows: economic development and structure of economy, employment and unemployment, transport and technical infrastructure, development potential and geographical location. These criteria will serve as the basis of decisions to channel investment to certain regions for the purpose of overcoming disparities more quickly and, in the long run, moving closer to EU standards.

The *areas of economic growth* will include municipalities with well developed infrastructure and entrepreneurship.

The class of *areas in industrial decline* will consist of municipalities where the restructuring of industrial structurally significant enterprises took place or is still taking place, thus resulting in lower production levels and higher unemployment. The group of *underdeveloped border areas* will include municipalities in which part of the administrative border coincides with the state border.

The category of *underdeveloped rural areas* will include municipalities where over 20 per cent of workers are employed in agriculture and forestry.

The definition of *underdeveloped mountainous areas* covers municipalities located over 500 m above sea level.

Before these changes were introduced, 43 of a total of 263 municipalities did not match the criteria for "target areas". Following the amendments to the law, only about a dozen municipalities will not fall within this category. All others will have the right and the opportunity to benefit from "targeted impact" funds provided by both the state and by EU funds.

The benefits of establishing the target areas and the criteria by law arise from the need to avoid subjectivity as much as possible.

### **Establishing Institutional Capacity for the Absorption of European Funds**

At its session in September 2005, the European Integration Council discussed Bulgaria's preparation for absorption of

<sup>40</sup> This happened during the conference entitled "A Visiting Card for Bulgarian Regions" held in Plovdiv on 27 December.

<sup>41</sup> Until now they were established by virtue of an Ordinance.

Structural Funds and the EU Cohesion Fund. The process of implementing extended decentralization was also discussed, as well as issues related to *building institutional and administrative capacity for the absorption of funds*.

At the end of the year, after drawn-out debates, a consensus was achieved on the Community's budget framework over the 2007-2013 period. Great Britain made an important concession, giving up about EUR 11 b of its special rebate to ensure more support to new Member States from Central and Eastern Europe. In return, France and all other countries made a commitment to review EU expenditures, and in particular the complicated system of farming subsidies from which French farmers seem to benefit the most. Germany, Britain and France, and also several other richer European countries will increase their contributions to the EU budget to provide the funds for the EU enlargement.

The final agreement was highly appreciated by European leaders as a good chance to avoid a crisis within the Union and ensure its successful future development.

*The total EU budget for the 2007-2013 period will be EUR 862.4 b.* It represents 1.045 per cent of the total GDP for this period. It should be noted however that it is lower than the budget proposed by Commission which envisaged 1.24 per cent of the total GDP for the period. Each Member State's contribution to the EU budget will be equal to 1.045 per cent of the national GDP.

Over this period *Bulgaria* will receive EUR 11.1 b, which is EUR 144 m more than originally proposed by the British government. It was once again underscored that the money Bulgaria will receive from EU pre-accession and structural funds is the largest on per capita basis, compared with all other new Member States.

The EUR 11 b for Bulgaria include 2.3 b for rural development and EUR 2.5 b for direct payments to farmers. The remaining EUR 6.5 b will be for structural and cohesion actions which means the construction of roads, support to improve the competitiveness of economy and of enterprises etc.

The adoption of operational programs will provide an opportunity to absorb financial resources under specific projects. These projects however must be adequately prepared and then submitted for support. Provided it is prepared for this, even during the first three years of EU membership Bulgaria could absorb EUR 2.3 b.

During the past year, the country engaged in training municipal and regional administrations to build absorption capacity for these funds. The leading role in organizing training was entrusted to the Ministry of Regional Development and Public Works (MRDPW). In early 2005, a project was launched under the joint

initiative of the MRDPW and the UN Development Program. The goal is to improve the potential of local administrations for *strategic planning* and in particular for developing municipal, regional (NUTS 3) and planning region (NUTS 2) plans – the key instruments of regional development. This training is in line with the country's commitments under Chapter 21 "Regional Policy", of EU negotiations.

Substantial support in strategic planning will be provided by the development of a *Universal Program* (Manual) for project planning and preparation. Assistance will be provided in developing regional strategies and municipal development plans, with emphasis on exchange of experience and best practices in various municipalities.

The training activities are targeted at regional and municipal administrations, as well as at regional development councils<sup>42</sup>. Representatives of non-governmental organizations, the business community, social workers and cultural institutions will also be included in the training process.

These developments show that there is a serious desire to implement *the best mechanisms and instruments* to improve the strategic planning and project development capacity for regional development.

### New Approaches in Regional Development: Clustering

Clustering, a relatively new approach in regional development in Bulgaria, continued last year. This is one of the most efficient instruments for regional development, economic growth and reducing regional disparity.

The creation of clusters is in line with the EU policy of convergence between countries and regions and is of particular significance for regions of untapped economic and labor potential. This approach is directly related to regional policy, reducing disparities and the full use of the capacity of economically underdeveloped areas. At least two conditions need to be met at the regional level: the appropriate infrastructure, (incl. transport, telecommunication, energy) and development of the physical and human capital. Also important are the adequate functioning of institutions and the improved capacity of local administrations. Establishing an adequate infrastructure for *innovation development* (wide use of information and communication technology) is of particular importance to the prosperity and improved competitiveness of regional economies.

In *Bulgaria* the unification especially of small and medium-sized enterprises in interrelated production networks became particularly popular during the second half of 2004 and 2005. The key drivers for cooperation are the striving for better solutions to common problems, the facilitation of marketing or

<sup>42</sup> See Regulations on the organisation and functions of Region Development Councils (NUTS 2), promulgated in OG, No 79 of 10 September 2004

business strategies, better network of trading outlets, logistics and more opportunities for innovative solutions.

Various branches of industry and regions in the country formed the following clusters:

- cluster Sevlievo – production and additional businesses;
- cluster Rousse - manufacture of clothing and related production in a number of SMEs (association for providing the necessary services, markets, marketing, supplies);
- cluster Devnya – a group of core production enterprises sharing the same problems (mostly environmental and infrastructure);
- cluster Srednogorie-copper - a group of companies from the same industry to establish the necessary infrastructure and organize the provision of relevant services;
- cluster Dobrich – production of shoes (currently there are about 20 companies that sprang up on the foundation of the former state-owned factory (now out of business) that meet all the necessary preconditions for establishing a cluster etc).

Cluster formation in Bulgaria is encouraged under the *PHARE Program*. Clusters will receive support worth about EUR 1 m under two PHARE projects. One of them, worth EUR 800 thousand, will be a pilot project to establish two tie-ins and finance consultant services for their implementation. The second project is worth EUR 250 thousand and its implementation was scheduled to start at the end of 2005. 15 clusters are expected to receive support as part of this second project.

PHARE financing will also be used to develop a *National strategy for support of clusters*.

### Strengthening Local Government and Enhancing Fiscal Decentralization

#### **Agreement between the Bulgarian Government and the Association of Municipalities**

As a step towards improving local government, in October 2005 a *Cooperation Agreement* was signed between the Bulgarian Council of Ministers and the National Association of Municipalities.

*The objectives* listed in the Agreement include: the provision of efficient public services, meeting citizens' actual needs while bringing down the number and the cases of overlapping of regulatory procedures; establishing a sustainable and efficient interaction between the central and local authority based on the principles of partnership, coordinated action etc.

*The priorities* of the cooperation include: decentralization in financial management and funding, expanding the scope and improving the condition and management of municipal property

and infrastructure, targeted preparation of municipalities for Bulgaria's EU membership.

*The forms* of co-operation are very diverse and require: ongoing dialogue between the government and municipal authorities; continuing the practice of establishing joint workgroups on key issues related to local government reform; participation of municipalities in the drafting of legislation on important matters of local government; wider contribution of NAMRB representatives in advisory, managerial and monitoring bodies working with the structures the central executive authority; participation of local government representatives in the process of planning, management, assessment and control on the implementation of plans, programs and projects financed from EU funds etc.

As part of the dialogue between the central and local government, particular importance is attributed to the issues of *financial decentralization*. Municipal authorities believe that changes are needed in the legislation laying down the rules of local government. This concerns the adoption of the *Local Finance Act* regulating in a new way payments from the national budget of public services provided by municipalities. This new legislation should also regulate the efficient and transparent management of taxpayers' money, and the relationship between local and central government budget.

Efficient financial decentralization requires a stable revenue base for municipalities. According to the NAMRB, this can be achieved in several ways: by increasing the size and scope of local tax when re-distributing the tax burden, by transforming personal income tax into a local tax; or by introducing municipal VAT or turnover tax. These are some of the NAMRB proposals on forming municipal finance.

Municipal leaders continue to insist on the adoption of the amendments to the Constitution submitted to the previous National Assembly; these changes would enable mayors to establish the type and size of local tax and charges; another proposal was that a new financial decentralization program should be discussed and adopted.

An event of major significance for developments in the field of fiscal decentralization was the *conference* held in early March 2005 under a project of the Center for Economic Development "Fiscal Decentralization in Bulgaria: the Next Steps – Increasing The Autonomy of Local Governments" with financial support from LGI/OSI<sup>43</sup>.

According to experts, the *problems* of fiscal decentralization in Bulgaria arise from flaws in the current legislation, severely restricted sources of municipal revenues, the need to further streamline municipalities' spending and insufficient municipal investments.

<sup>43</sup> The Local Government and Public Service Reform Initiative of the Open Society Institute, Budapest, works on issues related to "financial decentralisation, financial management and budgeting".



Some of the key *proposals* include:

- Changes in legislation - above all, in the Constitution, allowing municipalities to establish and administer local taxes and charges; giving tax autonomy to local government in respect of local taxes and charges; placing under the control of local government of additional taxes (local business tax, farming land tax etc.).
- Expanding the revenue base -providing local government with opportunities to encourage economic activity by granting certain economic agents tax-exempt status for certain local taxes; increase the collection rate for local tax revenues; updating of the size of local charges depending on the investment and cost involved.
- Streamline spending - include an investment component in the standards for delegated activities; participation of the private sector in the provision of public services through public-private partnership for the purpose of more efficient management of municipal property.
- Achieving the financial sustainability of municipal budgets - comprehensive asset management by calculating the rate of return from the revenues they generate minus the maintenance cost; strengthen the cooperation and collaborative efforts of municipalities in developing joint projects for financing from international funds and programs etc.

### Some Good practices in Local Government

#### **Public-Private Partnerships**

Over the past years a number of good practices have been introduced in local government. Serious attention is given to public-private partnerships in developing strategic and planning documents for municipalities and in implementing specific projects.

Local authorities and the business community are working in cooperation through a dedicated municipal unit responsible for work with investors - the Advisory Councils (for instance at the Dobrich municipality). Their goals include: the preparation of a programs in support of the development of existing enterprises and developing marketing strategies to provide fast and comprehensive information to potential investors. Of major significance is the Labor Force Profile Analysis in municipalities and the measures for staff training and re-qualification. Some municipalities are also developing Investor Promotion Programs, providing for preferential treatment: for instance discounts on lease paid for municipal sites.

A good example in promoting public-private partnership is the project "Marketing of Bulgarian Municipalities and Local Economic Development" implemented by the Foundation for Local Government Reform. The project is supported by the United States Agency for International Development. As part of the project, 8 municipalities were given special Business

Development Certificates. These are the municipalities of Dobrich, Silistra, Gabrovo, Montana, Pleven, Razgrad, Stara Zagora and Haskovo. An assessment of municipalities' capacity to efficiently apply good practices and introduce successful governance models was performed. The assessment criteria on preparedness to work with businesses include: establishing a labor force development program, participation by businesses in important decision-making processes by the municipality through Advisory Councils, developing detailed information on available buildings and sites, establishing an Industrial Profile of the municipality, and others.

#### **Improving the Quality of Administrative Services**

Efforts to improve the quality of administrative services in Bulgarian municipalities are continuing. A good practice in this field is the international quality certificate ISO 9001:2000 granted to the regional and municipal administrations (the municipality of Kardjali and the Regional Administration of Veliko Tarnovo have such certificates). Documents are now being elaborated to introduce modern quality management systems for the services to citizens and organizations.

In general, certification is an important point in the administration's activity. It represents a process of evaluation of a given organization as compared to international or sector standards. The evaluation is carried out by an independent accredited certifying body and is submitted to an international certification organization. Based on the positive evaluation, the regional and municipal administrations are awarded an internationally recognized Certificate of Quality.

This good practice also allows local administrations to improve the quality of services provided, and upgrade the image of their respective regions thus attracting a greater number of investors.

### Conclusion

2005 was of enormous importance for the country's preparedness to conduct an efficient regional policy. A number of activities were implemented on strategic planning, improving the project development capacity to absorb European funds, providing greater autonomy to local government in economic development and applying good practices in local self-government. Major efforts are however needed both as regards strategic planning and the preparation of local administrations and improving qualification through the propagation of good practices and public-Private partnerships.

*The past year was marked by numerous legislative amendments dictated by Bulgaria's main political objective in the present period – accession to the EU in 2007. By that date Bulgaria must complete successfully the harmonization of national legislation with European law. Thus at the end of its term of office the XXXIX National Assembly passed amendments to the Constitution of the Republic of Bulgaria. The most important of them include a right for EU citizens to acquire ownership over Bulgarian land as from the date of our accession to the Union. At the end of its mandate the XXXIX NA also approved significant amendments in the area of the executory process, introducing the institute of private executors, approved the Code of International Private Law, some important acts regarding registry proceedings, public offering of securities and public procurement. In the first months of its term of office the XL National Assembly proceeded energetically with the harmonization of the national legislation with the *acquis*. The approved new Criminal Procedure Code (CPC) is among the most important achievements of Bulgaria's legislative body. It defines in a new way the role of the prosecutor and the investigating bodies in the pre-trial proceedings on criminal cases. The Parliament approved some amendments to the Commercial Code and to the regulation of public offering of securities and public procurement. In the beginning of 2006 NA envisages to approve the Insurance Code, the Administrative Procedure Code and the Tax Insurance Code. On the basis of the latter and on the Act on the National Revenue Agency (LNRA) of 2002 the National Revenue Agency became operational since 1 January 2006. In the last months of 2005 NA passed a number of statutory acts important for individual sectors as well as for the economy in general. In the spirit of the previous summary of economic legislation, we will discuss these amendments to national legislation, which concern the majority of or all the spheres of economic life and have importance for a wide circle of business representatives. The summary will focus on: the newly passed CPC, the regulation of administrative violations and punishments, technical requirements to products, consumer protection, public offering of securities, labor and insurance legislation, money transfers and other amendments to laws and regulations.*

### Criminal procedure code

Overall, the parliamentary represented political forces assess the newly passed CPC, prom., OJ, No. 86/28 October 2005, in effect since 29 April 2006, as conforming to the best EU practices and to the commitments which Bulgaria has undertaken in the accession process. The national representatives from all parliamentary groups supported the idea for promptness, efficiency and transparency laid down in the Criminal Procedure Code.

According to the new code the court preserves its central place in the judicial phase of the criminal procedure. The main reforms envisaged by CPC are in **the pre-trial procedure and the collection of evidence**. They are in line with EU's recommendations for **setting up criminal police** to replace the

offices of “investigator” and “preliminary investigator”. The objective is to avoid the overlapping of investigating bodies' functions and to guarantee efficiency and transparency of the pre-trial procedure. Criminal procedure norms confirming the role of the prosecutor in the pre-trial procedure are introduced. Investigating bodies act under the guidance and supervision of **the supervising prosecutor**. **New evidence collection methods** are included: **investigation by agent under cover, controlled delivery and trust deal**. These methods are included in the scope of the special intelligence means (SIM). The information collected using these methods constitutes valid evidence before the court. CPC introduces a completely new principle of **reasonable time-limit of the criminal procedure** and significantly supplements the principle of equality of citizens in the process. CPC regulates in a separate chapter special criminal case procedures – summary procedure, instant criminal procedure, summary court investigation before first instance, etc. In fulfillment of the undertaken commitment in the process of EU accession, new norms creating conditions for applying in national legislation international instruments – recognition and execution of foreign sentences, transfer of criminal proceedings, joint investigation teams, etc., are introduced.

The new CPC was criticized by some deputies and by the media mainly because of the need to pass amendments to the Constitution concerning the judicial reform, which had to precede the passing of CPC on second reading.

### Legal assistance

ACT on Legal Assistance was passed in connection with the implemented judicial reform (prom., OJ, No. 79/4 October 2005, in effect since 1 January 2006).

This law regulates the legal assistance under criminal, civil and administrative cases before all judicial instances. The legal assistances referred to in the law is provided by lawyers and financed by the State. The law aims at guaranteeing equal access of individuals to justice by ensuring and providing efficient legal assistance. The National Legal Assistance Bureau provides general and methodological guidance of the activity of legal assistance provision. The bar councils organize the provision of legal assistance in the respective region, mainly by appointing a lawyer from the bar, who is on the National Legal Assistance Register, to provide the legal assistance.

Legal assistance is provided to individuals with poor social status, specified in this and in other laws. This law substitutes the notion “legal assistance” for the previously used notion “official protection”.

Amendments and supplements to the CODE OF CIVIL PROCEDURE concerning the introduction of the legal assistance institute, the obligation for the party which has lost the action to pay charges and costs in the cause, have been passed, prom., OJ, No. 79/4 October 2005. Thus if the claim of the person who has been provided legal assistance is honored,

the subsequent charges and costs will be adjudged to the National Legal Assistance Bureau in proportion to the honored portion of the claim. In case of guilty verdict, the person who has been provided legal assistance owes costs in proportion to the rejected portion of the claim.

## Stamp duty

Amendments and supplements to the Code of Civil Procedure (CCP) have been passed, prom., OJ, No. 86/28 October 2005, in effect since 29 April 2006, suppl., No. 99/9 December 2005, in effect since 10 June 2006. They envisage relief for certain groups of individuals regarding the obligation to pay civil procedure charges and costs. Thus individuals, whom the president of the district court or the district judge has recognized on the basis of a declaration of their property status as not having enough means to pay the charges and costs, as well as the plaintiff in remedial actions for crimes for which there is judgment at law, are exempted from charges and costs. In connection with the implemented judicial reform and the fast process requirement, the remedial actions for crimes for which there is judgment at law, as well as the actions under Art. 186 of the Consumer Protection Act have been included in the scope of summary proceedings.

On the basis of the latest amendment to Tariff No. 1 to the Act on stamp duty and charges collectable by courts, the prosecution, the investigation services and the Ministry of Justice, promulgated in OJ, No. 94/2005, the charges collectable by the Registry Agency are determined according to the newly adopted Tariff of stamp duty collectable by the Registry Agency, approved by DECREE No. 243/14 November 2005, prom., OJ, No. 94/25 November 2005.

The Tariff of charges collectable by the Bulgarian Patent Office is amended with CoM Decree No. 235/7 November 2005, prom., OJ, No. 91/15 November 2005.

## Administrative violations and punishments

Amendments to the Act on Administrative Violations and Punishments (LAVP) aimed at regulating the responsibility of legal persons for crimes have been passed and promulgated in OJ, No. 79.

The introduction of **responsibility of legal persons for crimes committed in their interest by their employees** has been established as an international standard in the area of fight against crime. This standard was adopted and reflected in the respective anticorruption and other instruments of UN, the European Union, the Council of Europe and the Organization for Economic Cooperation and Development (OECD).

The absence of relevant legislation was subject to criticism and insistent recommendations addressed by the European

Commission, OECD's working group on corruption in international trade and GRECO to Bulgaria in the period 1999-2005. Thus there was an urgent need to pass the respective legislation with a view to European Union's assessment of Bulgaria's capacity to counteract crime in the period before its full membership.

In that connection, a new special Chapter IV, Administrative Penal Sanctions for Legal Persons and Sole Trades, was inserted in LAVP. It envisages sanctions for any legal person who has or would have enriched itself illegally from criminal actions of its managers, management bodies or representatives. The crimes for which the legal person is responsible are explicitly specified: money laundering, human traffic, production and distribution of substances, corruption crimes, terrorism, computer crimes, fraud, etc.

The legal supplements are in line with the standards of the instruments mentioned above with respect to the conditions for realization of legal persons' responsibility for crimes, including with respect to: the circle of crimes for which legal persons can be responsible; the circle of crime perpetrators – physical persons; the correlation between the sanctioning of legal persons and the criminal responsibility of the crime perpetrators – physical persons; the opportunity for sanctioning also in cases when the respective physical persons are abettors or assessors to crime; the opportunity for sanctioning also in cases when the benefit is not actually received; the solemnity and nature of the envisaged property sanction; the obligation to confiscate the illegally received benefit. Property sanction is also imposed regardless of the realization of the criminal responsibility of the criminal act perpetrator.

The procedure is initiated on the basis of a reasoned proposal of the respective prosecutor to the district court. The court examines the proposal sitting in public with the participation of the prosecutor. The decision is appealable or protestable before the corresponding court of appellate jurisdiction within 14 days from its communication. The decision of the court of appellate jurisdiction is final.

## Gambling act

The amendments and supplements to the Gambling Act, prom., OJ, No. 79/4 October 2005, ensure fulfillment of Art. 45, paragraph 2 of the Europe Association Agreement between the European Communities and their Member States on one part and the Republic of Bulgaria on the other part (OJ, No. 33/1993), which stipulates that by 1 February 2006 at the latest Bulgaria shall provide treatment for the establishment of Community companies and citizens which is not less favorable than the one it provides to its own companies and citizens (national treatment) regarding the organization of games of fortune, lotteries, etc.



The amendments introduce prohibition to carry out activities under the Gambling Act without a permit. A ban on keeping game of fortune facilities, including idle ones, in premises for which the State Gambling Commission has not issued permits is introduced. The law repairs some omissions which have become evident in the process of its implementation. In that connection a ban on the access of individuals under age to the gambling halls is introduced, similar to the one for casinos. The law creates additional legal guarantees for protection of the state and public interest in the field of games of fortune organization and carrying out and optimizes the administrative servicing of the organization of such games.

## Intellectual property

Amendments and supplements to the Act on Copyright and Neighboring Rights (LCNR), prom., OJ, No. 99/9 December 2005, in effect since 10 January 2006, were passed following the approved amendments and supplement to the Act on Marks and geographical Indications and the Act on Industrial Design, prom., OJ, No. 43, which were dictated by the need to eliminate the imperfections in the previous regulation of intellectual property relations. The passed amendments to the intellectual property legislation aim at harmonizing the national legislation with the *acquis* in the field. The amendments to LCNR are aimed at transposing the provisions of Directive 2001/84/EC concerning the right of resale in favor of the author of original works of art and Directive 2004/48/EC/29 April 2004 concerning the realization of intellectual property rights.

The first directive introduces provisions which guarantee to the authors of graphic and plastic art works, photographic works and some explicitly specified works of applied arts (tapestries, ceramic works, glass works) compensations expressed as a percentage of the selling price upon original's resale, possible subsequent first transfer of the ownership by the author to the first purchaser. This has been envisaged in Art. 20 of the law, but the regulation in the directive is more detailed and contains imperatively the amount of the percentage deduction from the selling price which the author of the work is entitled to. Every state can only regulate the bottom selling price below which deductions are not made.

The second directive concerns the measures and procedures applied in the civil procedure process for ensuring more efficient law enforcement and protection of the intellectual property rights, including copyright and neighboring rights.

The amendments to the existing law have been passed also in connection with the implementation of previous Community directives in the intellectual property field, in particular the issues concerning satellite relay, cable relay, leasing or lending audio and video carriers, etc.

The law envisages that its provisions, in particular those concerning the right of resale "shall be applied also with respect to any authors or their heirs who are citizens of or have permanent residence in EU Member States.

## Technical requirements to products

The latest amendments and supplements to the Act on Technical Requirements to Products, promulgated in OJ, No. 43/20 May 2005, called for passing of Ordinance on Conformity Marking<sup>44</sup>. The ordinance specifies the rules for applying and the graphical image of the conformity mark. The conformity mark comprises the initials "CO" and its graphic image is according to Annex No. 1 to the Ordinance.

In that connection, amendments and supplements to ORDINANCE on the terms and procedure of carrying out market supervision of 2003 have been approved, prom., OJ, No. 85/25 October 2005.

The Ordinance on the terms and procedure of carrying out market supervision of 2003 regulates the terms and procedure of carrying out market supervision of products for which essential requirements are specified in the ordinances referred to in Art. 7 of the Act on Technical Requirements to Products (LTRP). According to the amendments and supplements, the ordinance also regulates **the procedure of products destruction** when the supervision establishes that their incompliance with the essential requirements cannot be technically removed. According to the amendments, the market supervision shall be carried out by the president of the **State Agency for Metrology and Technical Surveillance (SAMTS)** through the market supervision bodies of the state agency. According to the supplement to Art. 4 of the ordinance, inspectors shall monitor marketed and/or put into operation products, collecting information about the outer appearance of the products and the existence of conformity mark **when such is required according to the ordinances referred to in Art. 7 of LTRP**.

## Foods ACT

According to the amendments and supplements to the Foods Act, prom., OJ, No. 87/1 November 2005, in effect since 1 May 2006, food production or trade establishments are registered by **the regional public health protection and control inspectorate (RPHPCI)** (according to the previous wording the control body was RHEI), by the regional veterinary service (RVS) respectively at establishment's location. The regional public health protection and control inspectorate registers establishments for production of **and wholesale trade in** foods of non-animal origin and establishments for **retail trade** in foods, except for **retail trade** establishments offering only foods of animal origin. The regional veterinary service registers establishments for production, processing, storage, packing

<sup>44</sup> DCoM No. 191/16 August 2005, prom., OJ, No. 69/23 August 2005.



and repacking of raw materials and foods of animal origin, establishments for wholesale trade in foods of animal origin, **as well as retail trade establishments offering only foods of animal origin.** Within 30 days from the filing of necessary documents or the removal of imperfections or irregularities the corresponding body carries out on the spot verification of establishment's conformity with the conditions referred to in paragraph 1. If inconformity with the requirements is established, the body issues a prescription and specifies a reasonable time limit for bringing to conformity. For retail trade establishments offering foods of animal origin, which are registrable in RPHPCI, a representative of the corresponding RVS is also involved in the on the spot verification. Within 15 days after the verification or bringing to compliance according to the prescription the corresponding body registers the establishment. Within 7 days after the registration pursuant to paragraph 7 the corresponding RHEI or RVS director issues registration certificates for the registered establishments.

According to § 61 of TFP of the Act amending and supplementing FA, by 30 September 2006 all establishments for production of and trade in foods shall develop and introduce a system of hazard analysis and control of critical points for production of safe foods pursuant to Article 18, paragraph 1 of FL, implemented since 1 January 2007.

## Consumer Protection ACT

The National Assembly passed Consumer Protection Act, prom., OJ, No. 99/9 December 2005, in effect since 19 June 2006, which repealed the existing ACT on consumer protection and trade rules. The repealed law conformed to some pieces of the European legislation in the field. The need to pass a new Consumer Protection Act was dictated by the necessity to transpose in the Bulgarian legislation a number of other directives approved after 1999.

The new law regulates consumer protection, the powers of government bodies, and the activity of consumer associations in the field. It aims at providing protection of the following basic consumer rights: right of information about the goods and services, right of protection against risks of acquiring goods and services which could be dangerous for consumers' life, health or property; right of protection of their economic interests upon acquisition of goods and services on the basis of misleading, unfair and unauthorized advertising, unfair commercial practices and sale methods, unequal contractual conditions and upon the provision of guarantees for the goods; right of compensation for damages incurred by defects of goods; right of access to court and out-of-court procedures for settlement of consumer disputes; right of education on issues concerning their protection; right of association for the protection of their interests; right of representation before government bodies taking decisions on issues, which concern them. The basic consumer rights regulated in the repealed Act on Consumer Protection and Trade Rules are expanded in accordance with

the recommendations contained in the UN Economic and Social Council Resolution of 1984. Comparative advertising, joint offers, contracts for fixed term right of enjoyment of real estate and the requirements to the instructions for use of goods offered to consumers are regulated for the first time. The legal regulation of consumer guarantees and claims is improved. The requirements of Art. 153 of the Amsterdam Treaty are transposed, which will help to take better account of the consumer protection policy in the implementation of other policies.

According to the legislator the new Consumer Protection Act fully transposes the European legislation requirements in the consumer protection field.

## Registration and Accounting of Sales in Trade Establishments

According to the amendments and supplements to Ordinance No. 4/16 February 1999 of the Minister of Finance on the registration and accounting of sales in trade establishments, as last amm. and suppl., OJ, No. 83/18 October 2005, in effect since 1 November 2005, persons selling goods and services, where the payments due are collected by Bulgarian Posts EAD, shall be exempted from the obligation to register and account effected sales by issuing cash register receipts, except in the event of bank payment.

## Public offering of securities

Recent years have witnessed significant changes in the regulation of public offering of securities aimed at its full alignment with the *acquis*. It should be noted that this regulation has registered dynamic developments since the time of passing of the law 10 years ago when such regulation did not exist at all. Modern legal instruments like compensation fund for investors in securities, contract fund, "European passport" of investment brokers and management companies, etc.

The latest amendments concern the purview of investment services and activities, the **licensing and minimum capital** of investment brokers, the set up of a Fund for Compensation of Investors in Securities, the regulation of the contract fund as a type of collective investment scheme, and the requirements to management companies. It should be noted, that **the amendments concerning capital requirements and the licensing of investment brokers take effect since 1 January 2006.**

Two pieces of legislation concerning the subject matter of public offering of securities have been passed – Rules on the Structure and Activities of the Fund for Compensation of Investors in Securities<sup>45</sup> and Ordinance No. 22 / 29 July 2005 on the terms and procedure of entry in and deletion from the register of the

<sup>45</sup> By decision No 40-P / 10 August 2005 of FSC, prom., OJ, No. 69 / 23 August 2005.

Financial Supervision Commission of public companies, other issuers of securities and securities issues<sup>46</sup>.

**Amendments** to Ordinance No. 11/3 December 2003 on licenses for carrying out activity of a stock exchange, organizer of unofficial securities market, investment broker, investment company, management company and special investment-purpose company are promulgated in OJ, No. 84 / 2005 (amended title – OJ, No. 84 / 2005).

The ordinance regulates **the terms and procedure of issuing licenses** for carrying out activity of stock exchange, organizer of unofficial securities market, investment broker, investment company and management company, of **issuing permits** for the organization and management of a contract fund by the Financial Supervision Commission and of issuing by the latter of **approvals** pursuant to the Act on Public Offering of Securities (LPOS). The amendments to LPOS, prom., OJ, No. 39/2005 **substituted license treatment for permit treatment**. The amendments and supplements to Ordinance No. 11 aligned it with the law.

The ordinance regulates also the terms and procedure of **issuing** by the commission of **licenses** for carrying out activity of special investment-purpose company and of issuing by the commission of permits pursuant to the Act on Special Investment-Purpose Companies (LSIPC) for transformation or dissolution of special investment-purpose companies.

## Labor legislation

The amendments and supplements to the Labor Code, prom., OJ, No. 83/18 October 2005 are aimed at ensuring the safety and health at work on the basis of risk assessment. In 2000 the European Commission recommended to the Government, the nationally represented employer organizations and the syndicates to substitute the health risk prevention approach for the principle of compensations for harmful working conditions which is inconsistent with the acquis.

In that connection, according to the new wording of Art. 137 of LC, reduction of working hours can be specified for workers and employees who work under **specific conditions and the risk for their life and health cannot be reduced or eliminated regardless of the measures taken, but the reduction of working hours limits the risks for their health**, as well as for workers and employees below 18 years of age. The Council of Ministers specify with an ordinance the types of work for which reduction of working hours is applied.

Workers and employees are entitled to additional paid annual leave of not less than 5 working days for work under specific conditions and risks for their life and health, which cannot be removed, limited or reduced regardless of the measures taken. The Council of Ministers specifies with an ordinance the types of work for which additional paid annual leave is applied.

The latest amendments and supplements to LC cover also the regulation of the property accountability of the employer in the event of death or damages to the health of the worker or employee – Art. 200 of LC. Thus the amounts received under workers and employee's insurance contracts are deducted from **the compensation payable by the employer** for accident at work or occupational illness damages resulting in temporary disability, permanent disability of more than 50% or death of the worker or employee.

Amended are also the provisions concerning the free food for workers – Art. 285 of LC (before the amendments the wording was "free protective food").

## Health insurance

Amendments and supplements to the Health Insurance Act (HIL) were passed in the beginning of the year. They are aimed at improving the regulation of the health insurance obligations of certain groups of Bulgarian citizens. Thus Bulgarian citizens with long-term residence abroad are exempted from their health insurance obligations for past periods under certain conditions. The transitional provisions of the Health Insurance Act create an opportunity for this group of Bulgarian citizens to withdraw of their own will and under certain conditions from the health insurance system.

The new §19 of the Transitional and Final Provisions of HIL, prom., OJ, No. 45/2005 specifies the preconditions for prolongation of health insurance obligations. Thus persons owing health insurance contribution for their account till 1 June 2005 may request prolongation of their obligation until 31 December 2006, provided that in the period 1 October 2004 – 31 March 2005 the average monthly income per member of their family is not more than BGN 200 inclusive. By 31 December 2005 such persons had to file in the regional offices of the National Social Security Institute an application-declaration for prolongation of their obligation as per a form approved by the manager of the National Social Security Institute.

## Restriction of administrative regulation and administrative control

A fundamental principle of the ACT on Restriction of Administrative Regulation and Administrative Control of Economic Activity (LARACEA) in effect since 2003, amm. and suppl., OJ, No. 87/1 November 2005, is the principle of **statutory nature** of licensing and registration regimes. This principle prohibits for administrative regimes and the relevant administrative control to be laid down in bylaws. Bylaws do not lay down additional requirements; they only specify requirements laid down in a law. The law contains a comprehensive list of 39 licensing regimes. New licensing and registration regimes can be introduced or repealed by amendment and/or supplement to the lists

<sup>46</sup> Adopted by Decision No. 39-N / 29 July 2005 of the financial Supervision Commission, prom., OJ, No. 66 / 12 August 2005.

contained in the law passed by the National Assembly. Thus according to the new wording of item 25 of the list of economic activities, a license can be established for “production and use of veterinary products and **transportation of animals**”. A new item 40 providing for establishment of a license for “inland waterway cargo transportation” is inserted.

## Money transfers

Act on Money Transfers, Electronic Payment Instruments and Payment Systems was promulgated in OJ, No. 31/8 April 2005, in effect since 8 October 2005. The law provides comprehensive regulation of payment legal relations.

In pursuance of the law, ORDINANCE No. 3/29 September 2005 on money transfers and payment systems, prom., OJ, No. 81/11 October 2005 was approved with Decision No. 102/29 September 2005 of the Management Board of Bulgarian National Bank. The ordinance regulates:

1. bank accounts opening, keeping and accounting;
2. the main forms non-cash transfers, the procedure of making such transfers by banks and the payment instruments used;
3. the requirements for provision of information upon local and cross-border money transfers;
4. the error reclaiming methods for non-cash transfers;
5. the requirements to payment systems and the activity of system operators;
6. the settlement in Bulgarian National Bank (BNB);
7. the terms and procedure of issuing licenses for carrying out activity of system operator of payment system.

The ordinance repeals Ordinance No. 3/2002 on non-cash payments and the national payment system. The payment documents Paying-in Slip, Order-Receipt, Payment Demand Order for Prompt Collection, Payment Order, Budgetary Payment Order, Payment Order (Paying-in Slip) for Payment to the Budget and Banker's Order according to the annexes to the repealed Ordinance No. 3/2002 on non-cash payments and the national payment system shall be used till 1 June 2006. Till 1 June 2006 the previous account number format shall be used instead of the international bank account number (IBAN).

ORDINANCE No. 16/29 September 2005 on electronic payment instruments, prom., OJ, 81/11 October 2005, was approved with Decision No. 103/29 September 2005 of the Management Board of Bulgarian National Bank. The ordinance regulates:

1. the minimum content of contracts concerning the use of electronic payment instruments (hereinafter EPI);
2. the procedure of issuing bank payment cards and of making payments and other operations with such cards on Bulgarian territory;
3. electronic bank services;
4. electronic money issuing conditions;
5. the accountancy of electronic payment instruments;

6. the protection and exchange of information in connection with the use of EPI.

Electronic payment instruments are payment instruments allowing access to electronically registered or kept money and enabling deposits, transfers, cash drawdown, money value loading and unloading and/or other operations by electronic or other technical means.

Within the meaning of this ordinance electronic payment instruments are:

1. remote access payment instruments allowing the authorized holder access to bank account funds by way of electronic or other technical means like:
  - a) bank payment card;
  - b) electronic bank application for payment for electronic bank services;
2. electronic money instruments.

## Settlement of payment disputes

RULES on the activity of the Payment Disputes Conciliation Commission were approved with a view to facilitate payment disputes settlement.

The Rules on the Activity of the Payment Disputes Conciliation Commission issued by the Governor of BNB, prom/. OJ, No. 84/21 October 2005, regulate the activity of the Payment Disputes Conciliation Commission pursuant to the Act on Money Transfers, Electronic Payment Instruments and Payment Systems. The Payment Disputes Conciliation Commission functions at the Trade and Consumer Protection Commission. It is a conciliation body for settlement of disputes between:

1. executing institutions (Bulgarian National Bank, commercial banks, branches of foreign banks or other persons making transfers as part of their business) and their customers regarding transfers;
2. issuers of electronic payment instruments (BNB, commercial banks, branches of foreign banks with bank license including issuance of electronic payment instruments and other persons authorized to issue electronic money under legally regulated terms and procedure) and authorized holders of electronic payment instruments regarding the issuance and use of such instruments.

The commission examines disputes which have been referred to the executing institution or to an issuer of electronic payment instrument when such institution or issuer has failed to pronounce on the dispute within 7 days from protest filing date, as well as when the decision on the protest does not satisfy the customer, the authorized holder respectively. The parties do not pay any charge for examination of the dispute by the commission. The other expenses incurred by the parties (for representation, examinations, etc.) are for their account.

## Insurance

On 9 December 2005 FSC approved Ordinance amending and supplementing Ordinance No. 18 on mandatory insurance pursuant to Art. 77, paragraph 1, items 1 and 2 of the Insurance Act, prom., OJ, No. 101/16 December 2005.

Approved amendments liberalize the market and introduce the requirement for adequate amount of the minimum required risk premium to secure all obligations of the insurer obligations and to set aside insurance reserves.



## SMALL AND MEDIUM-SIZED ENTERPRISES IN BULGARIA

Main conclusions from the 2004 Annual Report prepared by the Center for Economic Development under assignment by the Ministry of Economy and Energy

Thriving small and medium-sized enterprises are the foundation of European economy. SMEs are a key factor in job creation, maintaining a competitive business environment, providing incentives for innovation and driving productivity.

At the same time, SMEs are more vulnerable to international competition, changes, related to the country's EU accession, internal regulations, tax policy, the condition of financial system etc. The need for government support precisely for small and medium-sized enterprises is justified, on the one hand, by their importance to economy, and, on the other hand, – by their impeded access to financing, especially during the initial phase in their development, the relatively higher administrative costs to achieve compliance with legal requirements, the difficulties they face in being provided with information on the latest developments in Bulgarian and EU legislation, new technology, and the changes in the markets and consumer preferences.

For this reason within the EU SMEs are one of the sectors in need of "special care". The leading principle in EU enterprise policy is "Think Small First". Bulgaria has fallen in line with this concept.

Over the past years, the significance of small and medium-sized enterprises in Bulgarian economy has been increasing. This relates to their contribution to employment, turnover, value added, fixed tangible assets, exports, and imports.

Small and medium-sized enterprises account for 99 per cent of all enterprises in the country. SMEs generate 79 per cent of employment, 75 per cent of turnover and 61 per cent of the value added in private enterprises. 57 per cent of tangible assets and 67 per cent of the investments in FTA for private enterprises are held by SMEs. SMEs generate 54 per cent of exports and 73 per cent of imports for private enterprises.

The number of small and medium-sized enterprises exceeds 216 thousand, or 99.2 per cent of the total number of enterprises and 99.8 per cent of private enterprises<sup>47</sup>. Micro-enterprises prevail in this group; they increased in number over the 2001-2003 period. Their share however in the total number of private enterprises has gone down, mostly at the expense of small enterprises whose share has increased. Medium-sized enterprises are the smallest class of SMEs and although they increased in number, their share has remained relatively constant – only 1.5 per cent. Large enterprises (250+ persons employed) only account for about 0.2 per cent of the total number of private enterprises in the survey.

<sup>47</sup> SMEs in this report are private enterprises from the sample with 1 to 249 (inclusive) persons employed. All enterprises in the sample (non-financial enterprises in subsectors C to K of the National Classification of Economic Activities '2003) are 218,136.

As regards industrial sectors, SMEs find trade and repair of motor vehicles most attractive; 55 per cent of all SMEs operate in this area. Manufacturing ranks second, followed by Hotels and restaurants and Real estate, renting and business activities. The section structures of individual size classes of enterprises differ considerably and thus reveal interdependence between size and the nature of the production processes. Retail trade is the most attractive economic branch for micro-enterprises. As regards small enterprises, they seem to find trade and manufacturing equally attractive. More than half of the medium-sized enterprises are active in manufacturing and, on to this indicator, they resemble large enterprises.

Although micro-enterprises prevail in each of the economic sectors discussed above, this does not, taken on its own, make them the "backbone" of activity in these sectors. Thus for example in trade micro-enterprises prevail in number and have a major contribution to employment for this industrial sector. At the same time, according to their contribution to value-added, small enterprises take the upper hand; these, with the quite modest share in the number of enterprises in the sector generate the bulk of added value in trade: 35.3 per cent.

As regards regional preferences the South-West planning region is most favored for business development. The North-West region is least favored. The breakdown of all SMEs by planning regions and the breakdown of size-classes by planning regions are almost identical and reconfirm the findings in previous reports on the acute territorial discrepancies which are relatively constant in time. These discrepancies, however slightly, have increased over the 2001-2003 period.

SMEs hold over half of the *fixed tangible assets* (FTA) of private enterprises. The bulk of FTA is concentrated in medium-sized enterprises. SMEs are considerably less equipped relative to large enterprises: the average value of FTA per SME is 313 times smaller than that of a large enterprise. The differences by size-classes are also many-fold: FTA in a medium-sized enterprise exceed 6 times the average value of FTA of small enterprises and 89 times those of micro-enterprises. The largest share of FTA in SMEs is concentrated in Manufacturing, followed by Trade.

The breakdown of SME's FTA by planning regions is rather uneven, with extreme values that persist over time. The almost identical breakdowns by FTA for different size-classes lead to the conclusion that the territorial attractiveness/unattractiveness of a given planning region does not depend on the size of enterprises. A demonstration of territorial attractiveness/

unattractiveness is the fact that over 45 per cent of SMEs FTA are concentrated in the South-West Region. At the other end of the scale is the North-West Region with below 4 per cent of SME's FTA; extremities in the distribution of larger enterprises go along similar lines. The smaller the enterprises are, the faster they replace their fixed tangible assets.

SMEs generate over 75 per cent of the turnover of private enterprises, in which individual size-classes have very similar shares, with micro-enterprises having the largest share. The average values of turnover per enterprise feature a many-fold difference between individual size classes. Smaller enterprises account for lower average turnover values. The turnover of a medium-sized enterprise is over 4 times larger than the turnover of a small enterprise and 50 times larger than the turnover of a micro-enterprise.

The value added generated by SMEs in 2003 represents 61.2 per cent of the value added of studied private enterprises. About one third of the SMEs value added is generated in the sectors of Repair of Motor Vehicles and Manufacturing. The contribution of SMEs to value added for the entire economy in 2003 was 20.8 per cent, and contribution to the Gross Domestic Product of the country was 16.2 per cent. It can be assumed that the shares quoted above underestimate the actual contribution of SMEs because enterprise data by size classes according to the number of persons employed do not include NSI adjustments, specially developed to cover the "shadow" economy. Nevertheless there is a trend of growing contribution of each size class to both value added and GDP. Our estimates of the actual contribution of private SMEs run at a rate of about 43 per cent of total GVA and about 34 per cent of GDP.

The productivity of SMEs accounts for 78 per cent of the productivity of private enterprises. The per-employee wage for SMEs equals 58 per cent of that in large enterprises or 85 per cent of that in private enterprises. The profit per person employed in SMEs equals 39 per cent of that for large enterprises or 75 per cent for all surveyed private enterprises. SMEs operate at a profit rate of 5 per cent, i.e. twice as low as that for large enterprises.

An increase is registered in the share of employees in the number of persons employed in SMEs; the increase is most considerable for micro-enterprises. This could be interpreted as evidence of a favorable process of shifting from family-based to market-based relationships in the organization of labor.

The characteristics for individual size classes reveal the following picture. Micro-enterprises are 90.2 per cent of private enterprises. They generate over 30 per cent of employment, 27 per cent of turn over and 16 per cent of the value added in private enterprises. 15 per cent of tangible assets and 22 per cent of the investments in FTA for private enterprises are held by micro-enterprises. They generate 10 per cent of exports and

15 per cent of imports for private enterprises. The productivity of micro-enterprises is 50 per cent of that for all private enterprises. The per-employee wage for micro-enterprises equals 64 per cent of that for all surveyed private enterprises. Micro-enterprises have the lowest profit rate, at 4.3 per cent.

Small enterprises are 8 per cent of all surveyed private enterprises. They generate 24 per cent of employment, 26 per cent of turn over and 21 per cent of the value added in private enterprises. 20 per cent of tangible assets and 25 per cent of the investments in FTA for private enterprises are held by small enterprises. Small enterprises generate 11 per cent of exports and 22 per cent of imports for private enterprises. The productivity of small enterprises equals 89 per cent of that for private enterprises, but exceeds the SME average. The per-employee wage for small enterprises equals 83 per cent of that for all surveyed private enterprises. Small enterprises operate at a profit rate of 5.2 per cent.

Medium-sized enterprises account for 1.5 per cent of all surveyed private enterprises. They generate 24 per cent of employment, 23 per cent of turn over and 24 per cent of the value added in private enterprises. 22 per cent of tangible assets and 19 per cent of the investments in FTA for private enterprises are held by small enterprises. Medium-sized enterprises generate 33 per cent of exports and 35 per cent of imports for private enterprises. The relative productivity of medium-sized enterprises is higher: 103 per cent of the productivity for private enterprises, but still far behind large enterprises whose relative productivity is 184 per cent. The per-employee wage for medium-sized enterprises equals 103 per cent of that for all surveyed private enterprises and exceeds the SME average. It is however equal to only 70 per cent of the per-employee wage for large enterprises. The profit rate for medium-sized enterprises is 5.7 per cent.

Various studies conducted over the past several years have outlined the profile of the Bulgarian small and medium-sized entrepreneur. He is male, about 42 years old, with general secondary or specialized secondary education, married, his business is located in a regional center; he has previous experience working for a state-owned enterprise or administration; he started his own company 10 years ago, using his own financial resources, lead by the desire to be independent; he has considerably improved his computer skills but has not made much progress in mastering foreign languages. Job satisfaction and financial security rank highly on his scale of values.

Women entrepreneurs and managers in Bulgaria are about 60,000 and account for one third of all entrepreneurs. They have a high level of education – 63 per cent of them hold university degrees and this percentage is well ahead of the average for most European countries. Women mostly run micro-enterprises with a staff of no more than 9 people; they are married, have children and work over 50 hours a week. The workers employed

by women have no prejudice about their employer's gender. Women rank as their priorities the improvement of the business environment, opportunities for participation in small public procurement, greater economic freedom and improvement in the tax legislation.

Efforts have been made over the past years to improve the *institutional and legal environment* for business and entrepreneurship in the country. Studies register an improvement, however small, SME managers' opinion of the business climate; the first signs of such improvement were registered after 2002.

The entry and exit dynamics for SMEs is highly influenced by the availability and opportunities to overcome barriers to businesses. Irrespective of their core business, all companies have faced problems related to legislation regulating their activity. The most common problems have to do with registration and authorization regimes. Efforts continue in upgrading the regulatory regimes and establishing favorable conditions for fair competition, bringing down the number of barriers to business start-up, simplifying the rules, curbing state intervention in business activity. Regretfully, companies still face many difficulties in start-up activities and business transactions.

A number of laws and regulations were adopted aiming to reduce the unjustified intervention of the state and local government authorities in business activity and increase the level of liberalization of market relations. Among the steps taken to improve the business environment, the reform in registration procedures should be specially noted. The newly adopted BULSTAT Act will introduce a single identification code, thus improving coordination, speeding up registration procedures and curbing corruption opportunities. An important step toward simplifying the regulatory environment is to transfer part of the administrative services to the private sector.

A number of *governmental and non-governmental organizations* are active in providing support to small and medium-sized enterprises. The new Executive Agency for SME Promotion was officially established in September 2004. An important focus in its activity is to step up the operation of regional units, intended to provide a more adequate response to entrepreneurs' needs for faster and better services.

A good solution in this respect was the establishment of public-private partnerships, including with non-governmental business organizations, to which certain powers can be delegated to provide, on private basis, public services to SMEs.

As a result of the stabilization and consolidation of the banking sector, SMEs gained better access to financing. Several trends are outlined in the financing of small and medium-sized enterprises: in 2003 bank credits grew considerably faster than commercial loans; bank lending registered a significant growth

of 65 per cent for short-term and almost 200 per cent for long-term loans; long-term commercial loans are lagging behind both in absolute terms and in terms of growth rate relative to other forms of financing.

In 2004 and early 2005 the credit expansion of commercial banks lead to the increased competition between them to attract new clients; it was borrowers who ultimately benefited from this. With regard to the types of loans, further diversification is observed in the main types of loans (working capital and investment). Bank lending terms have improved considerably. The collateral requirements have been used somewhat. Competition results in a considerable increase in the flexibility of repayment schedules and the scrapping of the business plan requirement. Decreasing interest rates are the most important development in SME lending.

Institutional and project-based financing for SMEs is expanding. Nevertheless SMEs continue to experience difficulties in securing the financial resources for business development. The opportunities for state support to SMEs through various guarantee schemes or co-financing are still not used to the full. Improved SME access to financing also means more information, and improved administrative capacity to absorb funds from international programs.

Issues related to *SME competitiveness* rise higher on the agenda in connection with the country's forthcoming EU membership. Bulgarian SMEs operate at low productivity which accounts for their insufficient competitiveness in international markets and the need to take steps towards improving it.

Improved competitiveness depends on a number of factors – the introduction of ICT and fostering innovative capacity, improved management and marketing, conducting a targeted human resource policy, adequate environmental policies, targeted preparation for EU accession, participation in clusters.

In these areas, SMEs need support from the state, business associations and other non-governmental organizations.

**Some of the key recommendations** to boost the role of SMEs in the economy and ensure that SMEs cope successfully with the pressure of market forces include:

- improving the business environment by streamlining regulatory regimes and encouraging competition on the market;
- improving SME access to financing, including through a National Guarantee Fund and municipal guarantee funds to promote the development of SMEs at the local level;
- improving the qualification of state and local administrations in support of SMEs and improving the quality of information and consultancy services to businesses;

- establishing a single database with information on the condition and needs of the SME sector and of existing programs;
- conducting active policy of technical upgrading of production by improving the co-operation between companies and research institutions;
- providing assistance in the introduction of international quality and environmental standards ;
- increasing the potential for development of finished products competitive in the international markets and specialisation in the production and export of high value-added products;
- launching targeted human resource and training policies in support of entrepreneurship;
- listing sustainable development as a component of enterprise policy;
- establishing conditions for the better absorption of EU structural funds;
- applying the cluster approach in the development of industrial sectors and regions.

Table 16. Role of SMEs in Bulgarian economy, 2001-2003

	Micro	Small	Medium-sized	Total SMEs	Large	TOTAL
Number of enterprises						
2001	188361	12183	2774	203318	500	203818
2002	183347	14334	2955	200636	521	201157
2003	195780	17388	3321	216489	532	217021
Number of persons employed						
2001	380888	237440	282483	900811	299053	1199864
2002	392031	277699	301084	970814	300518	1271332
2003	446133	337666	334612	1118411	298012	1416423
Number of persons employed per Enterprise						
2001	2.0	19.5	101.8	4.4	598.1	5.9
2002	2.1	19.4	101.9	4.8	576.8	6.3
2003	2.3	19.4	100.8	5.2	560.2	6.5
Turnover per enterprise, BGN thousand						
2001	80	1088	3713	190	30243	263
2002	97	1103	5148	243	28480	316
2003	97	1052	4933	248	33217	328
GVA per enterprise, BGN thousand						
2001	6	98	606	20	5524	33
2002	7	102	642	23	5452	37
2003	7	112	669	26	6666	42
Share of exports in turnover, %						
2001	6.1	8.4	18.7	10.2	37.1	17.8
2002	5.9	7.4	22.5	11.6	33.0	16.6
GVA per person employed, BGN thousand						
2001	3.0	5.0	6.0	4.4	9.2	5.6
2002	3.2	5.3	6.3	4.7	9.5	5.9
2003	3.2	5.8	6.6	5.0	11.9	6.5
Share of labor costs in GVA, %						
2001	38.7	52.4	59.2	51.4	54.7	52.7
2002	36.7	50.8	58.4	50.1	56.0	52.4
2003	43.5	51.4	57.6	51.9	47.8	50.3

Source: NSI and own estimates



# ANNEX 1: MAIN MACROECONOMIC INDICATORS

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Economic dynamics</b>															
<b>Industrial production</b>															
<b>Industrial production, volume index, 2000 =100, %</b>															
2005	135,4	138,4	166,0	150,0	142,3	156,6	155,9	148,2	154,7	161,7	168,9		146,6	149,6	152,9
2004	122,1	128,3	145,4	130,9	131,8	147,7	145,9	139,2	150,2	149,2	159,6	172,7	131,9	136,8	145,1
2003	111,9	107,3	125,5	114,2	108,3	121,4	125,6	117,8	128,3	130,8	130,2	142,1	114,9	114,6	123,9
<b>Industrial production, volume index, previous month =100, %</b>															
2005	78,4	102,2	119,9	90,4	94,9	110,0	99,6	95,1	104,4	104,5	104,5		-	-	-
2004	85,9	105,1	113,3	90,0	100,7	112,1	98,8	95,4	107,9	99,3	107,0	108,2	-	-	-
2003	93,2	95,9	117,0	91,0	94,8	112,1	103,5	93,8	108,9	101,9	99,5	109,1	-	-	-
<b>Industrial production, volume index, corresponding period of the previous year = 100, %</b>															
2005	110,9	107,9	114,2	114,6	108,0	106,0	106,9	106,5	103,0	108,4	105,8		111,1	109,4	105,4
2004	109,1	119,6	115,9	114,6	121,7	121,7	116,2	118,2	117,1	114,1	122,6	121,5	114,8	119,3	117,1
2003	118,9	114,4	122,6	109,8	107,9	113,8	111,9	109,6	114,9	116,6	110,2	118,3	118,7	110,5	112,2
<b>Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %</b>															
2005	110,9	109,3	111,1	112,0	111,2	110,2	109,7	109,3	108,5	108,5	108,2		111,1	110,2	108,5
2004	109,1	114,2	114,8	114,8	116,1	117,1	116,9	117,1	117,1	116,8	117,3	117,7	114,8	117,1	117,1
2003	118,9	116,7	118,7	116,4	114,7	114,5	114,1	113,5	113,7	114,0	113,6	114,0	118,7	114,5	113,7
<b>Industrial sales</b>															
<b>Industrial sales, volume index, 2000 =100, %</b>															
2005	135,8	136,5	171,4	154,4	151,6	166,8	168,9	164,4	164,7	177	181,6		147,9	157,6	166,0
2004	114,9	126,0	144,8	136,3	132,7	153,4	155,9	143,4	158,6	157,3	167,9	176,1	128,6	140,8	152,6
2003	108,1	104,1	124,8	114,1	112,5	122,8	125,9	118,3	125,7	129,7	127,5	138,0	112,3	116,5	123,3
<b>Industrial sales, volume index, previous month =100, %</b>															
2005	77,1	100,5	125,6	90,1	98,2	110,0	101,3	97,3	100,2	107,5	102,6		-	-	-
2004	83,3	109,7	114,9	94,1	97,4	115,6	101,6	92,0	110,6	99,2	106,7	104,9	-	-	-
2003	91,7	96,3	119,9	91,4	98,6	109,2	102,5	94,0	106,3	103,2	98,3	108,2	-	-	-
<b>Industrial sales, volume index, corresponding period of the previous year = 100, %</b>															
2005	118,2	108,3	118,4	113,3	114,2	108,7	108,3	114,6	103,8	112,5	108,2		115,0	111,9	108,8
2004	106,3	121,0	116,0	119,5	118,0	124,9	123,8	121,2	126,2	121,3	131,7	127,6	114,5	120,9	123,8
2003	117,8	115,8	130,0	109,6	116,2	117,1	112,2	110,5	115,2	120,1	113,2	117,0	121,4	114,3	112,6
<b>Industrial sales, from the beginning of the year, volume index, corresponding period of the previous year = 100, %</b>															
2005	118,2	113,0	115,0	114,6	114,5	113,4	112,6	112,9	111,7	111,8	111,4		115,0	113,4	111,7
2004	106,3	113,5	114,5	115,7	116,2	117,7	118,7	119,0	119,9	120,0	121,1	121,8	114,5	117,7	119,9
2003	117,8	116,8	121,4	118,2	117,8	117,6	116,8	115,9	115,8	116,3	116,0	116,1	121,4	117,6	115,8

ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Trade															
Trade and repairing activities, net receipts from sales, volume index, 2000 =100, %															
2005	146,5	145,7	168,6	168,7	166,8	180,5	185,5	195,9	193,7	204,6	202,6		153,6	172,0	191,7
2004	133,4	140,3	147,7	145,3	145,4	151,5	162,6	168,9	175,7	180,2	183,6	201,8	140,5	147,4	169,1
2003	120,0	127,3	137,3	133,1	135,3	139,1	148,3	149,5	152,5	158,5	149,1	170,0	128,2	135,8	150,1
Trade and repairing activities, net receipts from sales, volume index, previous month =100, %															
2005	72,6	99,5	115,7	100,1	98,9	108,2	102,8	105,6	98,9	105,6	99,0		-	-	-
2004	78,5	105,2	105,3	98,4	100,1	104,2	107,3	103,9	104,0	102,6	101,9	109,9	-	-	-
2003	82,8	106,1	107,9	96,9	101,7	102,8	106,6	100,8	102,0	103,9	94,1	114,0	-	-	-
Trade and repairing activities, net receipts from sales, volume index, corresponding period of the previous year = 100, %															
2005	109,8	103,8	114,2	116,1	114,7	119,1	114,1	116,0	110,2	113,5	110,3		109,3	116,7	113,4
2004	111,2	110,2	107,6	109,2	107,5	108,9	109,6	113,0	115,2	113,7	123,1	118,7	109,6	108,5	112,6
2003	118,0	118,9	119,8	121,3	121,5	119,1	117,8	114,7	116,7	115,8	112,6	117,2	118,9	120,6	116,4
Trade and repairing activities, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %															
2005	109,8	106,8	109,3	111,1	111,8	113,1	113,3	113,6	113,2	113,2	112,9		109,3	113,1	113,2
2004	111,2	110,7	109,6	109,5	109,1	109,0	109,1	109,7	110,3	110,7	111,9	112,6	109,6	109,0	110,3
2003	118,0	118,4	118,9	119,5	119,9	119,8	119,5	118,8	118,5	118,2	117,6	117,6	118,9	119,8	118,5
Inflation															
Inflation (Consumer price index - 100), previous month =100, %															
2005	0,7	0,9	0,3	1,1	-0,5	-1,3	0,1	0,6	1,4	1,2	1,0	0,8	-	-	-
2004	1,4	0,3	-0,1	0,3	0,0	-1,8	1,2	-0,4	0,9	0,2	0,6	1,3	-	-	-
2003	0,6	0,1	0,4	0,3	-0,6	-2,2	0,9	0,8	0,9	0,7	1,8	1,8	-	-	-
Inflation (Consumer price index - 100), December of the previous year = 100, %															
2005	0,7	1,6	1,9	3,0	2,6	1,2	1,3	1,9	3,3	4,5	5,6	6,5	-	-	-
2004	1,4	1,7	1,7	1,9	2,0	0,2	1,4	0,9	1,9	2,0	2,7	4,0	-	-	-
2003	0,6	0,8	1,2	1,5	0,8	-1,4	-0,5	0,3	1,2	1,9	3,8	5,6	-	-	-
Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %															
2005	3,3	3,9	4,3	5,1	4,6	5,1	3,9	5,0	5,4	6,5	6,9	6,5	3,8	4,9	4,8
2004	6,4	6,6	6,2	6,1	6,8	7,3	7,6	6,3	6,3	5,8	4,5	4,0	6,4	6,7	6,8
2003	1,7	0,2	-0,2	0,2	1,7	1,2	2,0	3,5	3,6	3,3	5,1	5,6	0,6	1,1	3,1
Employment and unemployment															
Unemployed persons registered, total, end of the period, number															
2005	486 414	485 504	471 296	449 740	427 198	411 586	405 493	399 026	388 548	386 494	383 930		471 296	411 586	388 548
2004	537 137	527 258	507 508	487 814	466 717	452 428	446 784	442 190	434 737	437 493	440 039	450 566	507 508	452 428	434 737
2003	646 757	611 727	581 350	552 068	528 718	506 424	489 343	480 881	472 614	476 326	489 618	500 664	581 350	506 424	472 614

# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, %															
2005	13,13	13,11	12,72	12,14	11,53	11,11	10,95	10,77	10,49	10,43	10,36		12,72	11,11	10,49
2004	14,50	14,23	13,7	13,17	12,6	12,21	12,06	11,94	11,74	11,81	11,88	12,16	13,70	12,21	11,74
2003	17,46	16,51	15,69	14,90	14,27	13,67	13,21	12,98	12,76	12,86	13,22	13,52	15,69	13,67	12,76
Newly opened vacant jobs, for the period, number															
2005	2 466	2 122	4 347	5 298	4 064	4 014	2 959	3 921	4 091	5 437	1 960		-	-	-
2004	3 286	4 772	5 050	3 538	4 090	4 571	4 085	2 966	3 009	6 232	7 198	2 992	-	-	-
2003	1 759	2 024	2 136	2 480	2 349	6 076	3 890	2 782	2 804	3 365	3 516	3 999	-	-	-
Employees, total, end of the period, number															
2005	2 117 190	2 127 571	2 144 669	2 164 483	2 173 806	2 191 194	2 213 145	2 208 613	2 199 515				2 144 669	2 191 194	2 199 515
2004	2 089 842	2 107 924	2 127 689	2 146 489	2 162 177	2 175 873	2 186 757	2 181 207	2 170 404	2 162 474	2 144 427	2 109 478	2 127 689	2 175 873	2 170 404
2003	1 946 834	1 991 623	2 016 828	2 043 764	2 054 972	2 068 694	2 075 881	2 067 291	2 063 429	2 050 282	2 034 033	2 005 369	2 016 828	2 068 694	2 063 429
Employees, public sector, end of the period, number															
2005	702 953	709 595	714 843	713 228	715 097	715 392	709 552	708 463	711 362				714 843	715 392	711 362
2004	751 635	759 485	766 657	767 878	769 983	770 520	742 194	738 504	739 786	737 760	733 506	717 920	766 657	770 520	739 786
2003	730 873	757 271	765 688	771 192	771 746	775 281	778 647	776 774	778 293	772 629	768 505	758 795	765 688	775 281	778 293
Employees, private sector, end of the period, number															
2005	1 414 237	1 417 976	1 429 826	1 451 255	1 458 709	1 475 802	1 503 593	1 500 150	1 488 153				1 429 826	1 475 802	1 488 153
2004	1 338 207	1 348 439	1 361 032	1 378 611	1 392 194	1 405 353	1 444 563	1 442 703	1 430 618	1 424 714	1 410 921	1 391 558	1 361 032	1 405 353	1 430 618
2003	1 215 961	1 234 352	1 251 140	1 272 572	1 283 226	1 293 413	1 297 234	1 290 517	1 285 136	1 277 653	1 265 528	1 246 574	1 251 140	1 293 413	1 285 136
Employees, total, end of the period, growth to corresponding month of previous year=100															
2005	1,3	0,9	0,8	0,8	0,5	0,7	1,2	1,3	1,3				0,8	0,7	1,3
2004	7,3	5,8	5,5	5,0	5,2	5,2	5,3	5,5	5,2	5,5	5,4	5,2	5,5	5,2	5,2
2003	3,6	5,7	6,7	7,8	7,8	8,1	8,2	8,0	7,2	6,9	6,0	4,9	6,7	8,1	7,2
Employees, public sector, end of the period, growth to corresponding month of previous year=100															
2005	-6,5	-6,6	-6,8	-7,1	-7,1	-7,2	-4,4	-4,1	-3,8				-6,8	-7,2	-3,8
2004	2,8	0,3	0,1	-0,4	-0,2	-0,6	-4,7	-4,9	-4,9	-4,5	-4,6	-5,4	0,1	-0,6	-4,9
2003	-4,0	-0,6	0,7	2,8	3,5	4,3	5,6	5,6	5,1	5,0	2,8	0,3	0,7	4,3	5,1
Employees, private sector, end of the period, growth to corresponding month of previous year=100															
2005	5,7	5,2	5,1	5,3	4,8	5,0	4,1	4,0	4,0				5,1	5,0	4,0
2004	10,1	9,2	8,8	8,3	8,5	8,7	11,4	11,8	11,3	11,5	11,5	11,6	8,8	8,7	11,3
2003	8,9	10,1	10,8	11,0	10,6	10,5	9,9	9,5	8,5	8,1	8,1	8,0	10,8	10,5	8,5

ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Fiscal review															
State budget															
Revenues of the Consolidated State Budget, total, BGN million															
2005	1 326,2	2 536,1	4 166,5	5 759,6	7 349,7	8 846,2	10 302,7	11 758,7	13 241,0	14 676,0	16 203,4		4 166,5	8 846,2	13 241,0
2004	1 126,0	2 110,6	3 636,8	5 097,6	6 375,6	7 646,9	8 996,5	10 311,4	11 622,1	12 978,2	14 304,5	15 858,1	3 636,8	7 646,9	11 622,1
2003	1 029,2	1 944,8	3 220,6	4 631,2	5 813,3	6 830,5	8 054,1	9 158,9	10 311,4	11 573,2	12 657,0	14 072,0	3 220,6	6 830,5	10 311,4
Expenditures of the Consolidated State Budget, total, BGN million															
2005	1 238,2	2 401,7	3 687,1	5 086,4	6 354,9	7 719,0	9 169,4	10 440,4	11 705,7	13 032,6	14 424,1		3 687,1	7 719,0	11 705,7
2004	1 152,7	2 260,2	3 408,4	4 568,7	5 665,8	6 769,3	8 019,8	9 119,7	10 322,3	11 502,8	12 826,5	15 198,9	3 408,4	6 769,3	10 322,3
2003	1 130,6	2 105,4	3 109,8	4 221,5	5 195,0	6 203,4	7 402,7	8 429,7	9 463,7	10 602,5	11 758,1	14 071,1	3 109,8	6 203,4	9 463,7
Consolidated State Budget deficit (-) /surplus (+), BGN million															
2005	88,0	134,4	479,3	673,1	994,8	1 127,3	1 133,3	1 318,2	1 535,2	1 643,4	1 779,3		479,3	1 127,3	1 535,2
2004	-26,7	-149,5	228,4	528,9	709,7	877,6	976,7	1 191,7	1 299,7	1 475,3	1 478,0	659,2	228,4	877,6	1 299,7
2003	-101,5	-160,6	110,8	409,7	618,3	627,1	651,4	729,2	847,8	970,7	898,9	0,9	110,8	627,1	847,8
Revenues of the Republican Budget, total, BGN million															
2005	908,8	1 670,6	2 756,1	3 865,8	4 935,5	5 890,1	6 840,9	7 779,6	8 721,6	9 652,8	10 604,7		2 756,1	5 890,1	8 721,6
2004	777,1	1 368,7	2 343,4	3 368,2	4 241,3	5 098,0	5 912,6	6 764,3	7 571,6	8 434,5	9 276,0	10 186,8	2 343,4	5 098,0	7 571,6
2003	651,3	908,4	1 937,0	2 878,1	3 626,4	4 221,2	4 985,2	5 637,7	6 279,0	7 051,8	7 684,9	8 441,6	1 937,0	4 221,2	6 279,0
Expenditures of the Republican Budget, total, BGN million															
2005	859,6	1 624,7	2 355,2	3 242,2	4 008,8	4 882,4	5 839,4	6 580,7	7 382,3	8 164,5	8 992,9		2 355,2	4 882,4	7 382,3
2004	841,2	1 531,5	2 222,5	2 963,0	3 640,1	4 315,5	5 134,6	5 773,9	6 575,3	7 249,0	8 019,3	9 757,0	2 222,5	4 315,5	6 575,3
2003	737,0	1 195,6	1 846,2	2 594,1	3 016,6	3 639,2	4 372,7	4 979,0	5 520,4	6 200,7	6 952,7	8 552,2	1 846,2	3 639,2	5 520,4
Republican Budget cash deficit (-) / surplus (+), BGN million															
2005	49,2	45,9	400,9	623,6	926,7	1 007,7	1 001,5	1 198,9	1 339,3	1 488,3	1 611,8		400,9	1 007,7	1 339,3
2004	-64,0	-162,8	120,9	405,3	601,2	782,4	778,0	990,4	996,3	1 185,6	1 256,6	429,7	120,9	782,4	996,3
2003	-85,7	-287,2	90,8	284,0	609,7	582,0	612,4	658,7	758,5	851,1	732,2	110,6	90,8	582,0	758,5
Government and government guaranteed debt															
Government and government guaranteed debt, BGN million															
2005	14 387,5	14 210,7	14 319,2	14 382,2	14 635,9	14 689,7	13 755,2	13 519,7	13 512,6	13 532,0	13 791,7		14 319,2	14 689,7	13 512,6
2004	16 731,7	16 852,8	17 032,7	17 332,8	17 187,1	17 198,8	16 089,2	16 068,7	16 054,2	15 927,5	15 677,9	15 557,3	17 032,7	17 198,8	16 054,2
2003	17 547,9	17 638,7	17 560,2	17 679,7	17 062,1	17 364,8	17 466,7	17 858,3	17 194,7	17 140,1	16 930,8	16 509,7	17 560,2	17 364,8	17 194,7
Domestic government and government guaranteed debt, BGN million															
2005	2 700,2	2 724,9	2 732,1	2 732,5	2 768,1	2 772,2	2 847,1	2 794,7	2 797,4	2 833,7	2 843,4		2 732,1	2 772,2	2 797,4
2004	2 331,3	2 397,3	2 425,6	2 462,3	2 475,3	2 494,5	2 494,7	2 536,8	2 568,9	2 597,8	2 627,4	2 680,6	2 425,6	2 494,5	2 568,9
2003	2 113,5	2 207,4	2 290,7	2 246,2	2 225,5	2 233,9	2 215,4	2 236,5	2 218,1	2 193,7	2 248,4	2 241,2	2 290,7	2 233,9	2 218,1



# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Foreign government and government guaranteed debt, BGN million															
2005	11 687,3	11 485,8	11 587,1	11 649,9	11 867,8	11 917,5	10 908,1	10 725,0	10 715,2	10 698,4	10 948,1	12 876,6	11 587,1	11 917,5	10 715,2
2004	14 400,4	14 455,5	14 607,1	14 870,4	14 711,9	14 704,3	13 594,6	13 531,8	13 485,4	13 329,8	13 050,7	12 876,6	14 607,1	14 704,3	13 485,4
2003	15 434,4	15 431,3	15 269,8	15 433,7	14 836,3	15 131,1	15 251,2	15 621,8	14 976,6	14 946,6	14 883,4	14 268,6	15 269,8	15 131,1	14 976,6
Government and government guaranteed debt, ratio to the annual GDP, %															
2005	34,8	34,4	34,6	34,8	35,4	35,5	33,3	32,7	32,7	32,7	33,4	40,9	34,6	35,5	32,7
2004	44,1	44,4	44,8	45,6	45,2	45,3	42,4	42,3	42,3	41,9	41,3	40,9	44,8	45,3	42,3
2003	49,7	50,0	49,8	50,1	48,4	49,2	49,5	50,6	48,7	48,6	48,0	47,8	49,8	49,2	48,7
Domestic government and government guaranteed debt, ratio to the annual GDP, %															
2005	6,5	6,6	6,6	6,6	6,7	6,7	6,9	6,8	6,8	6,9	6,9	7,0	6,6	6,7	6,8
2004	6,1	6,3	6,4	6,5	6,5	6,6	6,6	6,7	6,8	6,8	6,9	7,0	6,4	6,6	6,8
2003	6,0	6,3	6,5	6,4	6,3	6,3	6,3	6,3	6,3	6,2	6,4	6,5	6,5	6,3	6,3
Foreign government and government guaranteed debt, ratio to the annual GDP, %															
2005	28,3	27,8	28,0	28,2	28,7	28,8	26,4	25,9	25,9	25,9	26,5	33,8	28,0	28,8	25,9
2004	37,9	38,1	38,5	39,2	38,7	38,7	35,8	35,6	35,5	35,1	34,4	33,8	38,5	38,7	35,5
2003	43,7	43,7	43,3	43,7	42,0	42,9	43,2	44,3	42,4	42,4	41,6	41,3	43,3	42,9	42,4
Domestic government debt, total, BGN million															
2005	2 700,2	2 724,9	2 732,1	2 732,4	2 768,0	2 772,3	2 847,1	2 794,7	2 797,4	2 833,7	2 843,4	2 680,6	2 732,1	2 772,3	2 797,4
2004	2 331,3	2 397,2	2 425,7	2 462,3	2 475,3	2 494,5	2 494,7	2 536,8	2 568,9	2 597,8	2 627,4	2 680,6	2 425,7	2 494,5	2 568,9
2003	2 111,6	2 205,8	2 289,4	2 245,3	2 225,1	2 233,9	2 215,5	2 236,5	2 218,2	2 193,6	2 248,4	2 241,1	2 289,4	2 233,9	2 218,2
Debt on Government Securities issued for budget deficit financing, BGN million															
2005	2 253,3	2 281,4	2 284,3	2 284,5	2 309,5	2 309,6	2 384,6	2 334,1	2 333,9	2 370,3	2 375,2	2 211,2	2 284,3	2 309,6	2 333,9
2004	1 822,7	1 889,3	1 914,9	1 949,0	1 967,8	1 986,8	1 985,9	2 033,6	2 072,6	2 112,2	2 151,6	2 211,2	1 914,9	1 986,8	2 072,6
2003	1 515,4	1 608,5	1 696,0	1 658,9	1 658,5	1 658,2	1 637,7	1 652,5	1 653,9	1 633,2	1 696,7	1 703,9	1 696,0	1 658,2	1 653,9
Debt on Government Securities issued for structural reform, BGN million															
2005	447,0	443,5	447,7	447,9	458,5	462,7	462,5	460,6	463,5	463,4	468,3	469,5	447,7	462,7	463,5
2004	508,6	508,0	510,8	513,3	507,4	507,6	508,9	503,2	496,3	485,6	475,8	469,5	510,8	507,6	496,3
2003	596,2	597,2	593,4	586,4	566,6	575,7	577,7	584,0	564,3	560,4	551,6	537,2	593,4	575,7	564,3
Foreign government debt, USD million															
2005	7 198,4	7 189,7	7 090,0	7 094,8	6 872,8	6 771,9	6 146,5	6 083,5	5 991,3	5 968,5	5 988,8	8 362,7	7 090,0	6 771,9	5 991,3
2004	8 620,0	8 635,2	8 587,7	8 545,4	8 621,3	8 587,6	7 815,4	7 821,0	8 004,8	8 117,7	8 286,0	8 362,7	8 587,7	8 587,6	8 004,8
2003	8 109,3	8 091,6	8 090,0	8 355,8	8 535,8	8 414,6	8 372,2	8 284,1	8 461,0	8 417,2	8 530,4	8 718,6	8 090,0	8 414,6	8 461,0
Foreign government guaranteed debt, USD million															
2005	590,7	595,6	590,4	623,7	593,5	596,1	597,9	605,4	606,1	608,0	599,3	604,8	590,4	596,1	606,1
2004	498,1	542,9	541,8	538,0	554,2	550,7	552,7	558,2	551,1	563,0	585,4	604,8	541,8	550,7	551,1
2003	426,3	415,3	416,0	427,8	432,0	425,8	453,4	443,6	461,3	464,3	473,5	495,5	416,0	425,8	461,3

# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Foreign economic relations and foreign investments															
Balance of Payments															
Current account, million USD															
2005	-362,9	-240,1	-301,8	-358,3	-350,8	-198,9	-101,7	-134,5	-279,7	-468,6	-549,6	-435,2	-904,8	-908,0	-515,9
2004	-309,3	-178,4	-187,1	-285,9	-278,3	-47,4	243,2	157,1	29,1	-276,0	-485,2	-435,2	-674,8	-611,6	429,4
2003	-183,1	-162,8	-100,6	-408,0	-256,0	20,6	22,3	136,1	-1,3	-250,5	-327,7	-344,9	-446,5	-643,4	157,1
Trade balance, (FOB), million USD															
2005	-259,7	-273,9	-320,1	-360,9	-498,2	-448,0	-377,0	-481,9	-485,8	-483,4	-548,7	-440,2	-853,7	-1 307,1	-1 344,7
2004	-195,1	-184,5	-256,1	-322,5	-370,3	-284,3	-164,6	-213,4	-193,2	-296,6	-465,6	-440,2	-635,7	-957,1	-571,2
2003	-72,3	-121,4	-118,3	-273,2	-302,0	-161,1	-205,5	-155,1	-149,4	-262,2	-321,1	-376,9	-312,0	-736,3	-510,0
Exports (FOB), million USD															
2005	839,3	843,5	1 045,8	966,7	934,5	998,3	1 034,4	961,2	951,4	1 110,3	1 036,7		2 728,6	2 899,5	2 947,0
2004	631,5	735,6	779,6	716,0	720,4	847,0	963,6	812,2	893,5	922,7	950,6	875,0	2 146,7	2 283,4	2 669,3
2003	564,8	542,0	648,5	585,5	596,0	657,2	708,1	604,5	657,7	704,6	635,0	636,9	1 755,3	1 838,7	1 970,3
Imports (FOB), million USD															
2005	-1 099,0	-1 117,4	-1 365,8	-1 327,5	-1 432,7	-1 446,3	-1 411,4	-1 443,1	-1 437,2	-1 593,7	-1 585,5		-3 582,2	-4 206,5	-4 291,7
2004	-826,6	-920,1	-1 035,7	-1 038,5	-1 090,7	-1 111,3	-1 128,2	-1 025,6	-1 086,6	-1 219,3	-1 416,1	-1 315,2	-2 782,4	-3 240,5	-3 240,4
2003	-637,1	-663,4	-766,7	-858,7	-898,0	-818,3	-913,6	-759,6	-807,1	-966,8	-956,0	-1 013,8	-2 067,2	-2 575,0	-2 480,3
Services, net, million USD															
2005	-30,9	-29,1	-29,7	-66,3	56,0	208,5	308,5	297,7	129,9	-34,4	-86,9		-89,7	198,2	736,1
2004	-25,5	0,9	-10,8	-53,4	80,3	220,1	342,7	315,2	142,6	-29,0	-59,4	-46,7	-35,4	247,0	800,5
2003	-22,4	-14,9	-24,5	-35,9	30,9	169,1	238,1	238,6	124,4	-23,2	-45,6	-41,2	-61,8	164,1	601,1
Income, net, million USD															
2005	-129,6	-16,8	-40,2	-14,3	-18,3	-66,9	-126,3	-43,1	-29,4	-43,1	-41,9		-186,6	-99,5	-198,8
2004	-147,2	-48,5	-24,3	-8,6	-54,2	-55,6	-83,0	-47,4	-37,8	-52,9	-58,2	-40,1	-220,0	-118,4	-168,2
2003	-128,9	-54,7	-25,5	-144,8	-29,5	-45,7	-75,2	-20,4	-55,4	-14,2	-13,9	-18,3	-209,1	-220,0	-151,0
Current transfers, net, million USD															
2005	57,3	79,6	88,2	83,1	109,7	107,5	93,2	92,8	105,6	92,2	128,0		225,1	300,3	291,6
2004	58,6	53,8	104,2	98,5	65,8	52,3	148,1	102,8	117,5	102,6	98,0	91,9	216,6	216,6	368,4
2003	40,5	28,2	67,7	45,9	44,7	58,3	64,9	73,0	79,0	49,1	52,8	91,5	136,4	148,9	216,9
Capital account, million USD															
2005	0,0	0,1	0,0	-1,2	0,0	0,0	0,0	0,0	0,0	0,0	-0,1		0,1	-1,2	0,0
2004	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
2003	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-0,1	-0,1	-0,1	0,0	0,0	0,0	0,0	-0,2

# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Financial account, million USD</b>															
2005	-169,3	775,2	744,3	349,1	564,3	266,0	-467,2	83,6	374,3	455,4	623,1	694,6	1 350,2	1 179,4	-9,3
2004	-80,4	393,1	262,6	153,4	503,8	586,8	-909,1	220,0	264,9	389,3	593,9	694,6	575,3	1 244,0	-424,2
2003	33,8	111,5	199,5	536,1	263,2	184,9	30,1	130,5	138,2	560,5	261,5	191,0	344,8	984,2	298,8
<b>Direct investment net, million USD</b>															
2005	145,2	42,9	271,8	198,1	179,8	111,8	534,0	26,9	132,7	139,9	64,3		459,9	489,7	693,6
2004	171,1	145,8	158,6	59,3	138,6	658,7	-840,3	88,6	48,7	258,2	420,1	918,4	475,5	856,6	-703,0
2003	134,6	119,2	194,9	153,9	226,4	159,1	214,9	141,6	130,5	397,2	64,3	133,6	448,7	539,4	487,0
<b>Direct investment abroad, million USD</b>															
2005	-8,6	-7,3	-4,7	-5,5	-4,6	-1,9	-9,6	-2,3	-252,8	-0,4	-12,5		-20,6	-12,0	-264,7
2004	-7,2	-2,7	-5,6	-1,2	-1,5	-2,8	-3,1	-0,2	-2,9	-6,5	254,5	-0,4	-15,5	-5,5	-6,2
2003	-5,8	-0,3	-1,5	-1,5	0,6	-0,5	0,4	-4,3	-2,5	-1,5	-1,3	-8,4	-7,6	-1,4	-6,4
<b>Direct investment in Bulgaria, million USD</b>															
2005	153,8	50,2	276,4	203,6	184,4	166,4	171,3	56,6	412,8	140,2	76,8		480,4	554,4	640,7
2004	178,3	148,5	164,2	60,5	140,1	443,0	180,2	88,8	51,6	264,7	165,6	918,8	491,0	643,6	320,6
2003	140,4	119,6	196,3	155,3	225,8	159,6	214,5	145,9	133,0	398,8	65,7	142,0	456,3	540,7	493,4
<b>Mergers and acquisitions net, million USD</b>															
2005	0,0	0,0	0,0	0,0	0,0	-53,0	372,0	-27,0	-27,0	0,0	0,0		0,0	-53,0	318,0
2004	0,0	0,0	0,0	0,0	0,0	218,5	-1 017,3	0,0	0,0	0,0	0,0	0,0	0,0	218,5	-1 017,3
2003	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
<b>Portfolio investment assets, million USD</b>															
2005	252,9	-171,4	-112,6	126,8	47,9	-31,2	14,3	-45,4	-78,2	57,6	3,7		-31,1	143,5	-109,3
2004	-64,5	-17,3	36,6	-71,9	27,6	28,2	43,9	18,2	35,4	25,7	249,0	-298,9	-45,2	-16,1	97,5
2003	13,5	9,9	-19,8	10,8	87,3	-37,2	-87,3	-55,9	29,3	-36,7	24,9	-18,6	3,6	60,9	-113,9
<b>Portfolio investment liabilities, million USD</b>															
2005	-965,0	45,3	0,7	18,5	93,9	82,7	-458,8	11,6	100,8	71,1	53,1		-919,0	195,1	-346,4
2004	-106,3	-48,9	43,1	-15,7	8,1	125,0	-747,8	-11,5	25,6	-4,2	28,2	18,8	-112,1	117,4	-733,7
2003	-34,5	-13,4	-22,9	0,4	27,9	1,4	-79,4	-16,7	9,0	-14,9	5,5	4,5	-70,8	29,7	-87,1
<b>Other investment assets, million USD</b>															
2005	519,1	283,3	-129,6	83,6	-19,3	-149,5	-47,3	-53,4	-38,0	79,9	67,9		672,8	-85,2	-138,7
2004	-184,9	72,4	-123,3	106,7	95,8	-418,3	18,4	5,0	-63,1	-71,9	72,4	-432,3	-235,8	-215,8	-39,7
2003	-10,3	20,1	-55,2	285,6	-123,4	-37,0	-46,1	100,6	-139,6	174,5	114,0	-32,3	-45,4	125,2	-85,1
<b>Other investment liabilities, million USD</b>															
2005	-121,5	575,1	714,1	-77,8	262,1	252,2	-509,3	144,0	256,9	106,8	434,1		1 167,7	436,5	-108,4
2004	104,2	241,2	147,6	74,9	233,7	193,2	616,7	119,6	218,4	181,5	-175,8	488,7	493,0	501,8	954,7
2003	-69,5	-24,4	102,6	85,4	45,0	98,6	28,1	-39,1	109,0	40,3	52,8	103,9	8,7	229,0	98,0

ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Net Errors and Omissions (BP), million USD															
2005	-113,2	-333,6	-148,3	218,8	177,2	218,3	-21,7	279,8	102,0	15,1	79,1		-595,1	614,3	360,1
2004	7,5	-71,9	127,4	207,1	134,9	-41,1	90,1	-6,0	-48,4	167,8	207,4	-81,0	63,0	300,9	35,7
2003	-150,5	96,4	-16,6	46,9	97,5	-137,7	-54,1	-149,4	-62,1	21,1	174,6	78,5	-70,7	6,7	-265,6
Overall balance (BP), million USD															
2005	-645,5	201,5	294,2	208,4	390,7	285,4	-590,6	228,9	196,6	1,8	152,5		-149,8	884,5	-165,1
2004	-382,1	142,8	202,9	74,6	360,4	498,3	-575,8	371,1	245,6	281,1	316,0	178,4	-36,4	933,3	40,9
2003	-299,8	45,1	82,3	175,0	104,7	67,8	-1,6	117,1	74,7	331,1	108,4	-75,4	-172,4	347,5	190,2
Reserves and Related Items, million USD															
2005	645,5	-201,5	-294,2	-208,4	-390,7	-285,4	590,6	-228,9	-196,6	-1,8	-152,5		149,8	-884,5	165,1
2004	382,1	-142,8	-202,9	-74,6	-360,4	-498,3	575,8	-371,1	-245,6	-281,1	-316,0	-178,4	36,4	-933,3	-40,9
2003	299,8	-45,1	-82,3	-175,0	-104,7	-67,8	1,6	-117,1	-74,7	-331,1	-108,4	75,4	172,4	-347,5	-190,2
Finance															
Financial indicators															
Exchange rate BGN / USD, average for the period															
2005	1,49095	1,50304	1,48228	1,51176	1,54322	1,60785	1,62492	1,59115	1,59728	1,62794	1,65963	1,64975	1,49209	1,55428	1,60445
2004	1,54992	1,54671	1,59447	1,63352	1,63153	1,61138	1,59469	1,60646	1,60010	1,56630	1,50571	1,46055	1,56370	1,62548	1,60042
2003	1,84170	1,81554	1,81026	1,80353	1,68361	1,67717	1,72003	1,75641	1,74550	1,67286	1,67178	1,59306	1,82250	1,72144	1,74065
Exchange rate BGN / USD, end of the period															
2005	1,50044	1,47532	1,50866	1,50948	1,58611	1,61746	1,61732	1,6034	1,62417	1,62674	1,66185	1,65790	1,50866	1,61746	1,62417
2004	1,57932	1,57500	1,59999	1,63709	1,60340	1,60907	1,62428	1,61492	1,57614	1,53555	1,47110	1,43589	1,59999	1,60907	1,57614
2003	1,80827	1,81393	1,79516	1,75710	1,65440	1,71159	1,72807	1,78991	1,67854	1,68287	1,63067	1,54856	1,79516	1,71159	1,67854
Basic interest rate, effective annual, average for the period															
2005	2,41	1,91	1,93	1,97	2,05	2,08	2,06	2,06	2,06	2,06	2,06	2,06	2,08	2,03	2,06
2004	2,82	2,52	2,44	2,58	2,86	3,84	2,46	2,45	2,42	2,42	2,44	2,38	2,59	3,09	2,44
2003	3,27	2,53	2,55	2,60	2,98	2,92	2,54	2,55	2,59	2,62	2,63	2,69	2,78	2,83	2,56
Money (M1), BGN million															
2005	10 045	10 201	11 331	10 552	10 790	11 167	11 494	11 713	11 566	11 792	11 729		11 331	11 167	11 566
2004	7 788	7 853	7 835	7 987	8 036	8 422	8 736	9 048	9 239	9 220	9 185	10 298	7 835	8 422	9 239
2003	6 291	6 377	6 274	6 435	6 560	6 834	7 110	7 314	7 416	7 422	7 377	8 030	6 274	6 834	7 416
Money (M2), BGN million															
2005	20 438	20 705	23 176	21 990	22 426	22 749	23 200	23 650	23 730	23 924	23 985		23 176	22 749	23 730
2004	16 439	16 655	16 678	17 081	17 270	18 033	18 293	18 282	18 675	18 777	18 791	20 302	16 678	18 033	18 675
2003	13 551	13 723	13 542	13 762	13 766	14 197	14 624	15 046	15 073	15 698	15 605	16 465	13 542	14 197	15 073



# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>International reserves of BNB, BGN million</b>															
2005	12 328	12 785	13 198	13 507	14 075	14 577	13 582	13 912	14 275	14 259	14 799		13 198	14 577	14 275
2004	9 841	10 112	10 494	10 605	11 167	11 953	11 033	11 607	12 163	12 576	12 996	13 242	10 494	11 953	12 163
2003	8 363	8 473	8 603	9 233	9 316	9 451	9 518	9 800	9 882	10 413	10 557	10 383	8 603	9 451	9 882
<b>Fiscal reserves at the Issue Department of BNB, BGN million</b>															
2005	3 370	3 756	4 265	4 475	4 781	4 804	4 130	4 101	4 245	4 378	4 654		4 265	4 804	4 245
2004	3 138	3 147	3 503	3 823	4 204	4 803	3 663	4 347	4 642	4 898	5 384	4 346	3 503	4 803	4 642
2003	2 793	2 804	3 028	3 633	3 873	3 747	3 766	3 767	3 832	3 971	4 177	3 280	3 028	3 747	3 832
<b>Banking system</b>															
<b>Claims on credits granted by the Commercial Banks, total, BGN thousand</b>															
2005	14 339 642	14 669 727	18 216 389	16 403 694	16 444 686	16 239 981	16 506 380	16 805 164	17 087 091	17 476 774	17 786 848		18 216 389	16 239 981	17 087 091
2004	9 565 122 <sup>1)</sup>	9 848 840	10 247 405	10 659 517	11 008 716	11 309 097	11 877 533	12 076 182	12 526 708	12 954 946	13 410 638	13 939 177	10 247 405	11 309 097	12 526 708
2003	6 444 818	6 563 130	6 816 766	7 167 024	7 424 452	7 727 590	7 866 307	8 171 994	8 471 157	8 904 325	9 114 301	9 454 164	6 816 766	7 727 590	8 471 157
<b>Credits to Resident Sector, total</b>															
2005	14 171 157	14 493 674	17 780 891	16 150 886	16 214 983	16 021 571	16 248 739	16 546 262	16 858 834	17 249 242	17 554 951		17 780 891	16 021 571	16 858 834
2004	9 465 473	9 747 743	10 131 312	10 545 411	10 904 864	11 189 803	11 754 355	11 938 957	12 379 729	12 803 003	13 253 413	13 782 870	10 131 312	11 189 803	12 379 729
2003	6 356 088	6 489 721	6 745 467	7 094 504	7 355 881	7 657 439	7 797 284	8 092 008	8 391 057	8 832 873	9 044 229	9 352 878	6 745 467	7 657 439	8 391 057
<b>Credits to Government Sector</b>															
2005	26 797	26 657	25 976	26 123	26 748	27 319	28 387	30 592	30 906	33 328	35 117		25 976	27 319	30 906
2004	24 891	27 795	26 973	26 451	26 628	28 026	28 586	28 556	28 361	28 265	28 505	26 760	26 973	28 026	28 361
2003	8 673	8 947	9 494	9 380	9 406	9 561	11 924	13 394	19 928	21 667	22 168	24 635	9 494	9 561	19 928
<b>Credits to Non-government Sector</b>															
2005	14 132 460	14 455 119	17 736 034	16 100 296	16 163 770	15 969 789	16 200 835	16 496 153	16 808 411	17 196 223	17 500 306		17 736 034	15 969 789	16 808 411
2004	9 440 582	9 719 596	10 104 001	10 518 659	10 877 937	11 161 514	11 720 617	11 905 251	12 346 446	12 769 818	13 219 990	13 744 209	10 104 001	11 161 514	12 346 446
2003	6 291 902	6 444 260	6 662 763	7 014 528	7 280 799	7 603 463	7 727 111	8 030 421	8 325 688	8 751 119	8 977 126	9 303 120	6 662 763	7 603 463	8 325 688
<b>Credits to Non-financial Public Corporations</b>															
2005	253 924	242 027	263 587	244 253	240 597	225 757	225 986	232 000	202 670	170 408	171 365		263 587	225 757	202 670
2004	-	245 972	231 880	232 625	244 408	243 272	226 689	207 946	225 757	266 988	261 609	261 341	231 880	243 272	225 757
2003	219 215	229 954	235 631	246 234	245 746	231 489	245 251	237 021	230 292	213 420	217 489	234 230	235 631	231 489	230 292
<b>Credits to Non-financial Private Corporations</b>															
2005	9 112 979	9 287 240	11 809 556	10 227 007	10 100 241	9 902 236	9 922 963	10 022 347	10 208 586	10 385 712	10 498 075		11 809 556	9 902 236	10 208 586
2004	6 785 654 <sup>2)</sup>	6 685 783	6 932 080	7 194 675	7 378 415	7 452 693	7 840 566	7 883 985	8 140 365	8 346 028	8 512 148	8 812 722	6 932 080	7 452 693	8 140 365
2003	4 715 900	4 800 569	4 949 708	5 202 209	5 377 904	5 604 204	5 575 897	5 774 664	5 956 901	6 287 344	6 412 770	6 641 717	4 949 708	5 604 204	5 956 901

# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Credits to Households and NPISH</b>															
2005	4 458 783	4 610 873	5 095 569	5 335 284	5 525 828	5 686 183	5 887 706	6 057 137	6 223 646	6 456 360	6 668 765		5 095 569	5 686 183	6 223 646
2004	2 530 436	2 655 236	2 802 335	2 950 438	3 107 317	3 302 537	3 487 977	3 644 450	3 806 347	3 976 297	4 158 518	4 373 864	2 802 335	3 302 537	3 806 347
2003	1 260 492	1 300 531	1 355 108	1 438 127	1 532 501	1 645 779	1 758 072	1 853 587	1 933 809	2 035 462	2 116 719	2 201 298	1 355 108	1 645 779	1 933 809
<b>Credits to Non-bank Financial Institutions</b>															
2005	306 774	314 979	567 322	293 752	297 104	155 613	164 180	184 669	173 509	183 743	162 101		567 322	155 613	173 509
2004	124 492	132 605	137 706	140 921	147 797	163 012	165 385	168 870	173 977	180 505	287 715	296 282	137 706	163 012	173 977
2003	96 295	113 206	122 316	127 958	124 648	121 991	147 891	165 149	204 686	214 893	230 148	225 875	122 316	121 991	204 686
<b>Credits to Monetary Financial Institutions</b>															
2005	11 900	11 898	18 881	24 467	24 465	24 463	19 517	19 517	19 517	19 691	19 528		18 881	24 463	19 517
2004	-	352	338	301	299	263	5 152	5 150	4 922	4 920	4 918	11 901	338	263	4 922
2003	55 513	36 514	73 210	70 596	65 676	44 415	58 249	48 193	45 441	60 087	44 935	25 123	73 210	44 415	45 441
<b>Credits to Non-resident Sector</b>															
2005	168 485	176 053	435 498	252 808	229 703	218 410	257 641	258 902	228 257	227 532	231 897		435 498	218 410	228 257
2004	99 649	101 097	116 093	114 106	103 852	119 294	123 178	137 225	146 979	151 943	157 225	156 307	116 093	119 294	146 979
2003	88 730	73 409	71 299	72 520	68 571	70 151	69 023	79 986	80 100	71 452	70 072	101 286	71 299	70 151	80 100
<b>Total assets, end of the period, BGN thousand</b>															
2005	24 597 489	25 134 799	29 073 279	27 506 218	27 578 273	27 926 520	28 118 573	28 827 257	29 708 535	30 015 493	30 462 443		29 073 279	27 926 520	29 708 535
2004	17 530 661	18 005 393	18 756 066	19 144 405	19 229 222	20 096 015	20 651 822	20 959 108	21 549 780	22 300 151	22 650 627	24 917 359	18 756 066	20 096 015	21 549 780
2003	14 470 798	14 527 980	14 976 602	14 754 441	14 752 332	15 359 751	15 706 435	16 019 647	16 386 230	16 621 238	16 608 301	17 323 643	14 976 602	15 359 751	16 386 230
<b>Total liabilities, end of the period, BGN thousand</b>															
2005	21 775 872	22 285 847	26 152 791	24 533 344	24 627 576	24 893 565	25 026 632	25 610 389	26 434 674	26 698 662	27 079 924		26 152 791	24 893 565	26 434 674
2004	15 198 323	15 634 800	16 340 560	16 727 099	16 843 176	17 660 577	18 158 670	18 410 401	18 959 571	19 673 263	19 947 650	22 185 115	16 340 560	17 660 577	18 959 571
2003	12 413 277	12 474 347	12 882 639	12 702 089	12 694 628	13 252 494	13 584 220	13 870 342	14 218 293	14 410 754	14 364 457	15 042 658	12 882 639	13 252 494	14 218 293
<b>Interest revenues, BGN thousand</b>															
2005	138 909	274 979	429 683	585 459	744 411	906 462	1 071 346	1 238 346	1 404 455	1 576 568	1 752 508		429 683	906 462	1 404 455
2004	96 863	194 892	299 962	406 956	519 732	637 944	755 537	877 578	1 000 921	1 128 028	1 258 998	1 391 229	299 962	637 944	1 000 921
2003	74 730	145 393	223 314	302 382	385 403	465 864	550 315	636 814	724 416	816 202	908 081	1 012 487	223 314	465 864	724 416
<b>Current profit/loss, BGN thousand</b>															
2005	61 908	85 653	128 889	181 898	200 851	277 482	337 959	403 667	461 521	502 921	552 544		128 889	277 482	461 521
2004	41 497	78 677	114 157	132 792	169 150	224 081	257 720	300 494	335 347	366 104	420 992	434 112	114 157	224 081	335 347
2003	98 482	122 770	125 420	148 232	180 278	218 487	242 268	266 588	293 663	322 514	355 375	379 817	125 420	218 487	293 663

# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Social policy and industrial relations															
Wage&Salary <sup>3)</sup>															
Average Monthly Wage&Salary of employees under labor contract, total, nominal, BGN															
2005	303	302	319	313	322	317	320	313	327				308	317	320
2004	277	277	290	287	295	289	295	291	303	296	303	320	281	290	296
2003	264	259	274	272	280	274	276	273	286	276	286	302	266	275	278
Average Monthly Wage&Salary of employees under labor contract, public sector, nominal, BGN															
2005	360	363	386	380	408	394	399	382	415				370	394	399
2004	327	321	350	335	361	343	351	349	375	354	366	400	333	346	358
2003	308	299	325	318	340	327	326	324	352	326	344	368	311	328	334
Average Monthly Wage&Salary of employees under labor contract, private sector, nominal, BGN															
2005	275	272	285	280	279	279	282	280	284				277	279	282
2004	249	251	256	260	257	258	265	261	265	265	269	278	252	258	264
2003	238	234	242	244	242	241	244	242	245	245	249	260	238	242	244
Real Average Monthly Wage&Salary of employees under labor contract, total, growth, corresponding period of the previous year =100, %															
2005	5,9	5,0	5,5	3,8	4,4	4,4	4,4	2,5	2,3				5,4	4,2	3,1
2004	-1,4	0,3	-0,3	-0,6	-1,4	-1,7	-0,7	0,2	-0,4	1,4	1,4	1,9	-0,5	-1,2	-0,3
2003	5,9	5,0	6,8	7,2	5,8	5,3	4,4	2,2	4,1	1,5	3,5	4,7	5,9	6,1	3,6
Real Average Monthly Wage&Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %															
2005	6,5	8,9	5,8	7,9	8,1	9,3	9,4	4,3	4,9				7,0	8,4	6,2
2004	-0,2	0,7	1,4	-0,7	-0,6	-2,2	0,0	1,3	0,2	2,7	1,8	4,5	0,6	-1,2	0,5
2003	7,3	4,7	7,1	6,4	5,1	3,8	3,4	0,3	3,5	-1,7	2,6	4,9	6,4	5,1	2,5
Real Average Monthly Wage&Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, %															
2005	6,9	4,3	6,8	2,5	3,8	2,9	2,4	2,2	1,6				6,0	3,1	2,1
2004	-1,7	0,6	-0,3	0,4	-0,6	-0,2	0,9	1,4	1,7	2,3	3,4	2,8	-0,5	-0,1	1,4
2003	6,8	6,6	7,7	9,1	6,7	7,2	4,9	3,9	4,1	3,5	3,5	4,3	7,0	7,7	4,3
Income and consumption of the households <sup>3)</sup>															
Total income, monthly, average per person, nominal, BGN															
2005	156,7	147,6	162,9	175,6	178,8	177,3	183,2	190,9	194,1	192,7	187,2		155,7	177,3	189,4
2004	141,3	135,6	148,7	157,4	161,7	161,9	183,8	172,5	176,8	171,6	176,4	219,1	141,8	160,3	177,7
2003	128,8	122,4	135,8	142,4	146,6	152,3	157,2	157,0	157,0	156,2	162,1	210,6	129,0	147,1	157,0
Cash income, monthly, average per person, nominal, BGN															
2005	152,2	144,5	158,1	167,4	167,5	166,3	170,1	176,6	180,5	179,8	170,7		151,6	167,1	175,7
2004	136,4	131,9	143,0	145,0	147,3	150,5	154,5	156,6	160,8	158,3	157,2	189,9	137,1	147,6	157,3
2003	124,5	118,3	130,2	132,5	134,2	139,1	142,2	142,0	142,2	140,7	137,2	175,3	124,3	135,3	142,1

# ANNEX 1: MAIN MACROECONOMIC INDICATORS

(Continued and end)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Total expenditure, monthly, average per person, nominal, BGN</b>															
2005	144,4	138,7	157,0	165,7	170,0	171,9	175,4	182,8	197,0	192,8	185,0		146,7	169,2	185,1
2004	140,5	131,6	142,0	156,4	160,0	151,6	176,2	169,5	177,7	169,0	170,2	204,0	138,1	156,0	174,5
2003	125,2	116,0	130,1	135,4	143,2	141,8	147,1	151,1	153,1	154,9	153,3	197,9	123,8	140,2	150,4
<b>Cash expenditure, monthly, average per person, nominal, BGN</b>															
2005	140,3	135,9	152,5	157,8	159,2	161,1	163,0	168,9	184,1	180,4	168,9		142,9	159,4	172,0
2004	136,3	128,3	136,9	146,8	148,0	140,7	163,2	155,7	164,3	156,2	153,3	175,7	133,9	145,1	161,0
2003	121,1	112,3	124,9	126,0	131,4	129,7	133,2	137,0	139,3	140,4	134,9	163,6	119,4	129,0	136,5
<b>Real total income, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2005	7,4	4,8	5,1	6,2	5,8	4,3	-4,1	5,4	4,1	5,4	-0,7		5,8	5,4	1,7
2004	3,1	3,9	3,1	4,2	3,3	-0,9	8,6	3,4	5,9	3,8	4,1	0,1	3,3	2,1	6,0
2003	11,6	7,9	7,5	8,7	5,5	11,1	12,2	6,3	2,0	3,0	7,0	2,0	8,9	8,5	6,7
<b>Real cash income, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2005	8,0	5,4	6,0	9,8	8,7	5,2	6,0	7,4	6,5	6,6	1,6		6,5	7,9	6,6
2004	3,0	4,6	3,5	3,1	2,7	0,9	0,9	3,7	6,4	6,4	9,6	4,2	3,7	2,2	3,7
2003	11,9	7,7	7,8	8,3	7,1	11,2	11,7	6,6	1,3	2,9	3,4	5,7	9,1	8,9	6,4
<b>Real total expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2005	-0,5	1,4	6,0	0,8	1,6	7,9	-4,2	2,8	5,1	7,1	1,7		2,3	3,4	1,2
2004	5,5	6,4	2,8	8,8	4,6	-0,4	11,3	5,5	9,2	3,2	6,2	-0,9	4,8	4,3	8,6
2003	12,4	3,3	8,3	8,9	3,1	7,3	7,9	3,7	0,1	4,3	3,1	1,9	8,0	6,4	3,8
<b>Real cash expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2005	-0,4	1,9	6,8	2,3	2,9	9,0	-3,9	3,4	6,3	8,4	3,0		2,8	4,7	2,0
2004	5,8	7,2	3,3	9,8	5,4	1,1	13,9	6,9	10,9	5,2	8,7	3,3	5,4	5,4	10,5
2003	12,8	3,1	8,9	8,6	4,8	7,7	7,7	4,3	-0,4	4,6	3,4	5,9	8,2	7,0	3,7

1) Excluding credits to Monetary Financial Institutions.

2) Including credits to Non-financial Public Corporations.

3) Average monthly values by quarter are calculated as simple average of monthly per capita values.

Sources: Employment Agency, Bulgarian National Bank, Ministry of Finance, National Statistical Institute and own calculations.

Acronyms:

GDP = Gross domestic product

" - " = Not applicable or missing data



## ANNEX 2: PROMULGATED REGULATORY DOCUMENTS

Title	Status	Official Journal
CODE OF CIVIL PROCEDURE	Amended/Supplemented	No. 79 / 4.10.2005 and No. 86 / 28.10.2005
TAX PROCEDURE CODE	Amended/Supplemented	No. 79 / 4.10.2005
ACT on the Bar	Amended/Supplemented	No. 79 / 4.10.2005
Legal Assistance ACT	New	No. 79 / 4.10.2005
RULES on the procedure of exercising the ownership rights of the State in commercial companies with state interest in their capital	Amended/Supplemented	No. 79 / 4.10.2005
ORDINANCE on money transfers and payment systems	New	No. 81 / 11.10.2005
ORDINANCE on electronic payment instruments	New	No. 81 / 11.10.2005
ORDINANCE on the discharge of genetically modified organisms in the environment and on their marketing	New	No. 81 / 11.10.2005
ORDINANCE on working with genetically modified organisms under controlled conditions	New	No. 81 / 11.10.2005
ORDINANCE on approval of municipal ownership act forms and of the registers laid down in the Municipal Property Act, and on the procedure of their creation, keeping and storage	Amended/Supplemented	No. 82 / 14.10.2005
ORDINANCE on food labeling and presentation requirements	Amended/Supplemented	No. 82 / 14.10.2005
Labor CODE	Amended/Supplemented	No. 83 / 18.10.2005
CoM DECREE on approval of Uniform Administrative Positions Classifier and of Ordinance on implementation of the Uniform Administrative Positions Classifier	Amended/Supplemented	No. 83 / 18.10.2005
CoM DECREE on approval of Structural Regulations of the Council of Ministers and its Administration	Amended/Supplemented	No. 83 / 18.10.2005
RULES on implementation of the Act on State Interior Financial Control	Amended/Supplemented	No. 83 / 18.10.2005
RULES on implementation of the Concessions Act	Amended/Supplemented	No. 83 / 18.10.2005
STRUCTURAL REGULATIONS of the Privatization Agency	Amended/Supplemented	No. 83 / 18.10.2005
STRUCTURAL REGULATIONS of the Ministry of Administration and Administrative Reform	New	No. 83 / 18.10.2005
ORDINANCE on the registration and accounting of sales in trade establishments	Amended/Supplemented	No. 83 / 18.10.2005
ORDINANCE on the terms and procedure of approval, financing and implementation of the regional development program, strategies and plans	Amended/Supplemented	No. 83 / 18.10.2005
CoM DECREE on the establishment of Economic Policy Council	New	No. 84 / 21.10.2005
RULES on the activity of the Payment Disputes Conciliation Commission	New	No. 84 / 21.10.2005
ORDINANCE on licenses for carrying out activity of a stock exchange, organizer of unofficial securities market, investment broker, investment company, management company and special investment-purpose company	Amended/Supplemented	No. 84 / 21.10.2005
ORDINANCE on the terms and procedure of keeping a Register of administrative structures and of acts of the bodies of the Executive	Amended/Supplemented	No. 84 / 21.10.2005
Health ACT	Amended/Supplemented	No. 85 / 25.10.2005
ORDINANCE on the terms and procedure of carrying out market supervision	Amended/Supplemented	No. 85 / 25.10.2005
ORDINANCE on the mandatory insurance pursuant to Art. 77, paragraph 1, items 1 and 2 of the Insurance Act	Amended/Supplemented	No. 85 / 25.10.2005
ORDINANCE on the procedure of declaring goods in writing before customs institutions	Amended/Supplemented	No. 85 / 25.10.2005 and No. 105 / 29.12. 2005
TAX PROCEDURE CODE	Amended/Supplemented	No. 86 / 28.10.2005
PENAL CODE	Amended/Supplemented	No. 86 / 28.10.2005 and No. 88 / 4.11. 2005
CRIMINAL PROCEDURE CODE	Amended/Supplemented	No. 86 / 28.10.2005
CRIMINAL PROCEDURE CODE	New	No. 86 / 28.10.2005
Customs ACT	Amended/Supplemented	No. 86 / 28.10.2005
Judicial Power ACT	Amended/Supplemented	No. 86 / 28.10.2005
ORDINANCE on norms for sulfur dioxide, nitrogen dioxide, fine dust particles and lead in the atmospheric air	Amended/Supplemented	No. 86 / 28.10.2005
ORDINANCE on the terms and procedure of creating and keeping a register of vineyards and a special vineyards map	New	No. 86 / 28.10.2005
Stockbreeding ACT	Amended/Supplemented	No. 87 / 1.11.2005
Veterinary Activity ACT	New	No. 87 / 1.11.2005
Apiculture ACT	New	No. 87 / 1.11.2005
ACT on restricting administrative regulation and administrative control of economic activity	Amended/Supplemented	No. 87 / 1.11.2005
ACT on local taxes and charges	Amended/Supplemented	No. 87 / 1.11.2005

## ANNEX 2: PROMULGATED REGULATORY DOCUMENTS

Waste Management ACT	Amended/Supplemented	No. 87 / 1.11.2005
ACT on the ownership and use of farm land	Amended/Supplemented	No. 87 / 1.11.2005
Fodders ACT	Amended/Supplemented	No. 87 / 1.11.2005
Foods ACT	Amended/Supplemented	No. 87 / 1.11.2005
ACT on the structure of the state budget	Amended/Supplemented	No. 87 / 1.11.2005
National Standardization ACT	New	No. 88 / 4.11.2005
Health ACT	Amended/Supplemented	No. 88 / 4.11.2005
Insurance ACT	Amended/Supplemented	No. 88 / 4.11.2005
ACT on railway transport	Amended/Supplemented	No. 88 / 4.11.2005
ACT on genetically modified organisms	Amended/Supplemented	No. 88 / 4.11.2005
ACT on Bulgarian Identity Documents	Amended/Supplemented	No. 88 / 4.11.2005
ACT on Biological Diversity	Amended/Supplemented	No. 88 / 4.11.2005
ACT on the safe use of nuclear energy	Amended/Supplemented	No. 88 / 4.11.2005
ORDINANCE on the terms and procedure of filing dossiers and exercising control of the conformity of geographical indications of agricultural and food products	New	No. 88 / 4.11.2005
ACT on Foreigners in the Republic of Bulgaria	Amended/Supplemented	No. 88 / 4.11.2005
Waste Management ACT	Amended/Supplemented	No. 88 / 4.11.2005
Statistics ACT	Amended/Supplemented	No. 88 / 4.11.2005
Regional Development ACT	Amended/Supplemented	No. 88 / 4.11.2005
ACT on Privatization and Post-privatization Control	Amended/Supplemented	No. 88 / 4.11.2005 and No. 94 / 25.11.2005 and No. 103 / 23.12.2005
ACT on the structure of the state budget	Amended/Supplemented	No. 89 / 8.11.2005
ORDINANCE on the requirements for treatment and transportation of used oils and waste oil products	New	No. 90 / 11.11.2005
CoM DECREE on approval of Tariff of charges for products generating mass waste after use	Amended/Supplemented	No. 90 / 11.11.2005
CoM DECREE on approval of Ordinance on the requirements for treatment and transportation of used oils and waste oil products	New	No. 90 / 11.11.2005
ACT on excise duty and tax warehouses	New	No. 91 / 15.11.2005
CoM DECREE on organization and coordination of the information exchange regarding information society technical regulations and service rules	Amended/Supplemented	No. 91 / 15.11.2005
Customs ACT	Amended/Supplemented	No. 91 / 15.11.2005
ORDINANCE on assessment and classification of risk exposures of banks and on forming provisions for depreciation losses	Amended/Supplemented	No. 93 / 22.11.2005
ORDINANCE on the minimum required reserves maintained by banks with the Bulgarian National Bank	Amended/Supplemented	No. 93 / 22.11.2005
ORDINANCE on the terms and procedure of registration of agricultural and forestry equipment	New	No. 93 / 22.11.2005
Health ACT	Amended/Supplemented	No. 94 / 25.11.2005
ACT on Protected Territories	Amended/Supplemented	No. 94 / 25.11.2005
Waters ACT	Amended/Supplemented	No. 94 / 25.11.2005
TARIFF of stamp duty collectable by the Registry Agency	New	No. 94 / 25.11.2005
ACT on fishery and aquacultures	Amended/Supplemented	No. 94 / 25.11.2005
ACT on Minerals and Ores	Amended/Supplemented	No. 94 / 25.11.2005
ACT on Local Taxes and Charges	Amended/Supplemented	No. 94 / 25.11.2005
ACT on Marks and Geographical Indications	Amended/Supplemented	No. 94 / 25.11.2005
Tourism ACT	Amended/Supplemented	No. 94 / 25.11.2005
RULES on implementation of the Employment Promotion Act	Amended/Supplemented	No. 95 / 29.11.2005
ACT on the clearness of atmospheric air	Amended/Supplemented	No. 95 / 29.11.2005
Value Added Tax ACT	Amended/Supplemented	No. 95 / 29.11.2005
Energy ACT	Amended/Supplemented	No. 95 / 29.11.2005
Measurements ACT	Amended/Supplemented	No. 95 / 29.11.2005
Environment Protection ACT	Amended/Supplemented	No. 95 / 29.11.2005
ACT on technical requirements to products	Amended/Supplemented	No. 95 / 29.11.2005
ACT on tobacco and tobacco products	Amended/Supplemented	No. 95 / 29.11.2005
Waste Management ACT	Amended/Supplemented	No. 95 / 29.11.2005

## ANNEX 2: PROMULGATED REGULATORY DOCUMENTS

CoM DECREE on development and implementation of financial recovery programs and monitoring of the financial condition of state-owned enterprises	Amended/Supplemented	No. 96 / 30.11.2005
RULES on implementation of the State Property Act	Amended/Supplemented	No. 96 / 30.11.2005
RULES on implementation of the Concessions Act	Amended/Supplemented	No. 96 / 30.11.2005
RULES on implementation of the Customs Act	Amended/Supplemented	No. 96 / 30.11.2005
ORDINANCE on border check-points	Amended/Supplemented	No. 96 / 30.11.2005
ORDINANCE on business trips and specializations abroad	Amended/Supplemented	No. 96 / 30.11.2005
ORDINANCE on licensing of railway enterprises for passenger and/or cargo transportation and of persons issuing safety certificates	Amended/Supplemented	No. 97 / 2.12.2005
ORDINANCE on hazardous chemical substances subject to prohibition or restrictions of their trade and use	Amended/Supplemented	No. 97 / 2.12.2005
ACT on genetically modified organisms	Amended/Supplemented	No. 99 / 9.12.2005
ACT on wine and alcoholic beverages	Amended/Supplemented	No. 99 / 9.12.2005
ACT on copyright and neighboring rights	Amended/Supplemented	No. 99 / 9.12.2005
CODE OF CIVIL PROCEDURE	Amended/Supplemented	No. 99 / 9.12.2005
Consumer Protection ACT	New	No. 99 / 9.12.2005
ACT on Consumer Protection and Trade Rules	Amended/Supplemented	No. 99 / 9.12.2005
Crafts ACT	Amended/Supplemented	No. 99 / 9.12.2005
Telecommunications ACT	Amended/Supplemented	No. 99 / 9.12.2005
Foods ACT	Amended/Supplemented	No. 99 / 9.12.2005
ACT on tobacco and tobacco products	Amended/Supplemented	No. 99 / 9.12.2005
Tourism ACT	Amended/Supplemented	No. 99 / 9.12.2005
ACT on postal services	Amended/Supplemented	No. 99 / 9.12.2005
ACT on the accreditation carried out by the Bulgarian Accreditation Service	New	No. 100 / 13.12.2005
Excise Duty ACT	Amended/Supplemented	No. 100 / 13.12.2005
Value Added Tax ACT	Amended/Supplemented	No. 100 / 13.12.2005
Local Taxes and Charges ACT	Amended/Supplemented	No. 100 / 13.12.2005
ACT on protection against the harmful effect of chemical substances and preparations	Amended/Supplemented	No. 101 / 16.12.2005
ORDINANCE on requirements to cosmetic products	New	No. 101 / 16.12.2005
ACT on the 2006 Budget of the National Health Insurance Fund	New	No. 102 / 20.12.2005
ACT on the 2005 Budget of the National Health Insurance Fund	Amended/Supplemented	No. 102 / 20.12.2005
REGULATION on specifying the basic package of health activities guaranteed from the budget of NHIF	Amended/Supplemented	No. 102 / 20.12.2005
ORDINANCE on the sale of chattels representing private state property	Amended/Supplemented	No. 102 / 20.12.2005
ACT on non-for-profit legal persons	Amended/Supplemented	No. 102 / 20.12.2005
Accountancy ACT	Amended/Supplemented	No. 102 / 20.12.2005
Political Parties ACT	Amended/Supplemented	No. 102 / 20.12.2005
Cooperatives ACT	Amended/Supplemented	No. 102 / 20.12.2005
Insurance CODE	New	No. 103 / 23.12.2005
Road Transport ACT	Amended/Supplemented	No. 103 / 23.12.2005
ACT on the Access to Public Information	Amended/Supplemented	No. 103 / 23.12.2005
Export Insurance ACT	Amended/Supplemented	No. 103 / 23.12.2005
Health ACT	Amended/Supplemented	No. 103 / 23.12.2005
Value Added Tax ACT	Amended/Supplemented	No. 103 / 23.12.2005
ACT on Personal Data Protection	Amended/Supplemented	No. 103 / 23.12.2005
ACT on Measures against Money Laundering	Amended/Supplemented	No. 103 / 23.12.2005
ACT on Corporate Income Tax	Amended/Supplemented	No. 103 / 23.12.2005
ACT on the Financial Supervision Commission	Amended/Supplemented	No. 103 / 23.12.2005
Health Insurance ACT	Amended/Supplemented	No. 103 / 23.12.2005
Patronage ACT	New	No. 103 / 23.12.2005
ACT on local taxes and charges	Amended/Supplemented	No. 103 / 23.12.2005
ORDINANCE on specifying the types of work for which additional paid annual leave is established	New	No. 103 / 23.12.2005
ORDINANCE on specifying the types of work for which reduction of working hours is established	New	No. 103 / 23.12.2005
COMMERCIAL CODE	Amended/Supplemented	No. 103 / 23.12.2005
ACT on the Structure of the Territory	Amended/Supplemented	No. 103 / 23.12.2005
ACT on Public Offering of Securities	Amended/Supplemented	No. 103 / 23.12.2005
ACT on Personal Income Tax	Amended/Supplemented	No. 103 / 23.12.2005
ORDINANCE on working hours, rests and leaves	Amended/Supplemented	No. 103 / 23.12.2005

## ANNEX 2: PROMULGATED REGULATORY DOCUMENTS

ACT on the 2006 Budget of the State Social Security	New	No. 104 / 27.12. 2005
Social Security CODE	Amended/Supplemented	No. 104 / 27.12. 2005
ACT on Guaranteeing the Claims of Workers and Employees in the Event of Insolvency of their Employer	Amended/Supplemented	No. 104 / 27.12. 2005
Concessions ACT	Amended/Supplemented	No. 104 / 27.12. 2005
Roads ACT	Amended/Supplemented	No. 104 / 27.12. 2005
ACT on the 2006 State Budget of the Republic of Bulgaria	New	No. 105 / 29.12.2005
TAX INSURANCE PROCEDURE CODE	New	No. 105 / 29.12.2005
ORDINANCE on the terms and procedure of issuing integrated permits for construction and operation of new or operation of existing industrial plants and facilities	Amended/Supplemented	No. 105 / 29.12.2005
2006 National Framework Agreement between the National Health Insurance Fund on one part and the Bulgarian Doctors Union and the Union of Dentists in Bulgaria on the other part	New	No. 106 / 30.12.2005



## A. GENERAL NOTES

*The review of the Bulgarian economy is an authentic expert product of the Center for Economic Development, made possible mostly owing to the long experience of the Center in the field of applied studies of the economic policy and economic development of the country.*

**Structure of the report.** The present report on the Bulgarian economy comprises:

- (1) a summary of the report,
- (2) economic analysis in 16 sectors described in detail in Topics and Sections,
- (3) In Focus section,
- (4) two annexes containing updated macroeconomic indicators and the regulatory documents promulgated in the review period,
- (4) these methodological notes,
- (5) English translation of the summary, and
- (6) chronicle of CED's activity in the review period.

**Review period.** The report contains detailed presentation and assessment of the fourth quarter of 2005 as well as assessments of the whole 2005. Where necessary, significant events, facts and data of periods before 2005 have been highlighted. Where possible, data comparisons have been made against previous years. At many points also the short-term trend has been outlined.

**Selection of Topics.** The structure of the presentation above follows two principles simultaneously. First, the strive is towards giving a more comprehensive presentation of the subject matter areas, with corresponding prioritization of the range of matters discussed. Second, the different topics and analyses reflect the experience of the experts from the Center for Economic Development.

**Topics and Sections.** The review of the Bulgarian economy starts with presentation of the *macroeconomic dynamics* discussed against the background of the following basic categories: GDP, foreign trade, foreign direct investments, inflation, employment and unemployment. After that, the annual values of the *Estat index of business climate* in Bulgaria and *NSI's monthly business surveys* are presented and compared. The national economic events in the review period, which have direct or indirect effect on the competitiveness of the Bulgarian enterprises, are analyzed in the section on the *enterprise policy*. Such events are described in the sub-sections on encouragement of entrepreneurship, investment promotion policy, access to finance, effectively functioning markets, commercial policy and preparation for the single European market, privatization and concessioning, regulatory regimes, public procurement, public administration reform, combating corruption, index of economic freedom. In the specific Bulgarian economic environment, the enterprise policy has two basic

aspects: (1) transformation, which is mostly associated with the process of privatization and liberalization of the economy, and (2) competitive orientation, which involves the policies to achieve economic growth and competitiveness of the Bulgarian enterprises. The corresponding section of the report studies problems concerning both aspects of the Bulgarian enterprise policy.

The *public finance* section covers the budget implementation and the fiscal reserve dynamics, the foreign and the domestic debt. The wide topic of *social and health policies* encompasses the issues of social security, employment and unemployment, labor market policy, incomes and social partnership. A review is made of the current problems and condition of the healthcare reform. The *environmental policy* is discussed both as a specific element of the economic policy and as a factor for the economic environment.

The financial system is discussed by means of the *banking sector*, *the insurance sector* and the *capital market*. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria – *energy, transport, high technology and communications, tourism and agriculture*. The section on *regional policy* studies the political decisions, facts and events relating to the achievement of balanced and sustainable development of the regions and reduction of the disproportions between them, as well as the process of social and economic cohesion with the European Union.

The annexes at the end constitute an integral part of the presentation. *Annex 1* presents in detail the basic macroeconomic indicators. *Annex 2* contains the list of newly passed legislation and amendments to laws, which are of significant importance to the economic development of the country, and have been promulgated in the Official Journal in the review period. Since the beginning of 2005, this annex also contains a brief review of the more important legislative amendments in the respective quarter.

**The work was finally completed on 15 January 2006.**

## B. SOURCES

**Basic Sources.** Statistical and other information and data from the sources below have been used in the analyses:

- National Assembly
- Council of Ministers
- Ministry of Agriculture and Forestry
- Ministry of Economy and Energy
- Ministry of Transport
- Ministry of Labor and Social Policy
- Ministry of Finance
- National Statistical Institute
- National Social Security Institute
- Employment Agency

- Executive Agency for Promotion of Small and Medium-sized Enterprises
- Privatization Agency
- Bulgarian National Bank
- Bulgarian Stock Exchange – Sofia AD
- Financial Supervision Commission
- Delegation of the European Commission
- European Union
- Eurostat
- European Bank for Reconstruction and Development
- Organization for Economic Cooperation and Development
- World bank
- Official Journal
- The periodical press

**Additional Sources.** We have also used the conclusions from a large number of own outputs and works, some of which are parts of assigned research projects, as well as analyses by other researchers. The particular sources and publications are quoted at the respective places in the text.

## C. THE ESTAT INDEX OF BUSINESS CLIMATE IN BULGARIA

*The business climate survey is based on own original methodology, developed by the team of the Agency for Social and Marketing Surveys Estat and the Center for Economic Development. The more significant details of the methodology are described below.*

**Methodology of the Sample.** The survey is conducted on a quarterly basis among the managers of some 400 companies. The sample is a two-level panel one (at the first level the companies are divided into groups by regions, and at the second level – according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices “number of employees” and “type of ownership”. The sample is a guaranteed representative one at the level of going concerns.

**Methodology of the Registration.** The information has been collected using the method of an inquiry at the work place. The interviews were held with the owners of the companies covered by the sample, or with persons authorized to make management decisions and to sign financial statement documents (managers, chief accountants, commercial or marketing directors).

**Questionnaire Content.** The questionnaire contains eight substantive questions and three passport questions. The integrated index is comprised of three basic components. The questions from one to five inclusive comprise Component I – “General Condition of the Company”; question six – Component

II – “Investment Attitudes and Corporate Strategies”; questions seven and eight – Component III – “Business Environment”.

**Index Calculation: (1) preliminary preparation.** The preliminary preparation includes weighting of the data according to the indicators “economic sector” and “number of employees”, recoding and calculating values for the respective questions.

- Questions with one possible answer – the original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done so as to have a scale from -2 (the lowest degree) to +2 (the highest degree).
- Multiple-choice questions – these questions are recoded in advance so that possible answers are located symmetrically on both sides of the neutral point (the zero).

**Index Calculation: (2) components.** The index for each component, which comprises an indicator question, is calculated as a weighted average value. Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component (“General Condition of the Company”; “Investment Attitudes and Corporate Strategies”; “Business Environment”) is calculated as a weighted average.

**Index Calculation: (3) integrated index.** The integrated index is calculated as a weighted average of the three basic components mentioned above. The weight for each of the components is determined by means of expert evaluation.

**Index Values.** The Estat index of business climate assumes values from -100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German IFO Business Climate Index:

-100	to -61	very poor
-60	to -21	poor
-20	to +20	average
+21	to +60	good
+6	to +100	very good

**Index Interpretation.** The integrated index, as well as the three basic components assume values within the interval [-100, +100]. The set of tools allows determining also the direction of the index. The difference between the values of questions Q3 (assessment of the expected condition), Q2 (assessment of the condition at a certain point in time) and Q1 (assessment of the condition during the preceding period) is applied as a criterion for determining the direction.

**Additional Notes.** Beside everything aforesaid about the methodology, in many places throughout the text additional methodological and other notes and comments are given.



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## EVENTS

### Participation in a Project within the Communication Program of the Delegation of the European Commission in Sofia

In October 2005 Mrs. Anelia Damianova, Senior Expert, CED, took part as lecturer in a project implemented within the Communication Program of the Delegation of the European Commission to Bulgaria. The project comprised a series of public debates organized in the central cities of the 6 planning regions.

The Communication Program is a major instrument of providing comprehensive information about the challenges of full EU membership.

The debates organized were aimed at making local entrepreneurs, administrations, municipalities and non-government organizations aware of the principle formulations of EU's regional policy, the capacity of the pre-accession funds and in particular of Community's structural funds and cohesion fund.

Presented during the debates were also Bulgaria's National Development Plan and the 6 operational programs to it which form the framework for drawdown of money from European funds till 2013. The focus was placed on some operational programs – the economic competitiveness enhancement program, the regional development program, and the agricultural development program.

Another important point of the debates was the presentation of the regional development plans for each one of the 6 planning regions. The objective was to comment on the basic economic development priorities of each region, the measures for their implementation and the role of the funds in the process. The purpose of the organizers was to popularize the planning and strategic documents and to seek the opinion and view of local communities.

The CED representative took part in the debates organized in Blagoevgrad, Burgas and Russe. Presentations on the development and potential of the tourist sector in each one of the



following planning regions – North-central, South and Southeast, were organized. A lecture on the condition of agriculture and cross-border cooperation in the Northwest planning region was prepared as well.

## The Meeting in Sarajevo



The meeting in Sarajevo at work

On 1 November 2005 Mr. Alexander Boshkov, CED Co-chair, delivered a public lecture on The European Perspectives of the Balkans in Sarajevo, the capital of Bosnia and Herzegovina. The lecture was organized by the Center for Interdisciplinary Post-graduate Studies; the Open Society Foundation, Bosnia and Herzegovina and the European Institute, Sofia, within European Commission's EU-Western Balkans Mutual Understanding, Relationship and Dialogue Support Project.

The main topics which the lecture touched on included:

- Bulgaria's experience of the relations with the European Union
- The transition to functioning market economy
- The relations with international financial institutions

Co-lecturers included Mrs. Dobrila Govedariza, Open Society Foundation; Mr. Ivan Barbalic, Center for Interdisciplinary Post-graduate Studies, Mr. Gianni la Ferrara and Mr. Davor Vuletic.

During his visit in Sarajevo Mr. Alexander Boshkov had a meeting with Mr. Osman Topcagic, Director, European Integration Directorate, Ministry of Foreign Affairs and Chief Negotiator with the European Union for Bosnia and Herzegovina.

## Seventh Forum for Southeast Europe, 2005



The Seventh Forum for Southeast Europe at work.

Representatives of the Center for Economic Development took part in the Seventh Forum for Southeast Europe (2 November 2005) on Development of Knowledge-based Economy in Support of Competitive SMEs.

Within the forum Mr. G. Prohasky, CED Co-chair, presided the panel on Competitive SME Policies. Major speakers included government sector representatives, advisors and business representatives. Mr. Stanimir Barzashki, Executive Director of the Agency for Promotion of SMEs, made a detailed review of the condition and environment for development of SMEs and of the latest changes in the environment aimed at promoting the development of and reducing the barriers to SMEs.

The main speakers included also representatives from neighboring countries: Tatjana Sagic, government sector, Ministry of Economy, Labor and Entrepreneurship, Croatia; Zora Simovic, state secretary, Ministry of Economy, Serbia; Zarco Juranovic, Euro Info Center, Macedonia; Antony O'Sullivan, Program Director, Southeast Europe Investment Charter, OECD; Teodora Mladenova, UNDP JOBS Project Director; Evgeni Ivanov, Consulting Director, JOB Project; Karlheinz Zan, Senior SME Advisor, Pro Regio. All speakers underlined the importance of SMEs as a source of employment as well as their potential as a source of innovations, enterprise and higher productivity. Due appreciation was also given to the importance of viable SMEs for the development of socially stable communities and for the existence of well-functioning market economy. Materials on the latest legislative changes and tax amendments were presented as well. The speakers discussed investments and specific measures to attract investments in the SME sector. Assessed was also the efficiency of implemented measures and their effect for the promotion of SMEs in the different countries.

The panel attracted the attention of representatives of business associations, local and central government, economic advisors and commercial attaches to the foreign embassies in Sofia, economic experts and many journalists. The discussion focused on the measures to promote employment, support sustainable SME sector development and environment conducive of public-private partnerships for economic recovery of local communities.

## Round Table on “Budget 2006. Is there an Alternative?”



The round table on “Budget 2006. Is there an Alternative?” at work

The discussion forum on “Budget 2006. Is there an Alternative?” organized by the Center for Economic Development, the Conrad Adenauer Foundation and the Democratic Alternative Foundation took place on 3 November 2005 in the Sheraton Hotel. Leading central and local right-wing politicians, representatives of the Executive, authoritative non-government economic organizations, the business, the syndicates, outstanding economic experts and media attended the forum.

CED Co-chair Mr. Alexander Boshkov was the leading moderator of the forum. He gave the lead of the overall discussion on the logic of changes in Budget 2006. His main conclusion, which was also confirmed in discussions on the different topics, was that Budget 2006 lacked uniform economic logic and that it actually repeated Budget 2005, aggravating its negative aspects.

Alternative revenue and expenditure sides of this budget, based on convincing economic logic, were presented. Mr. George Prohasky, the other CED Co-chair was moderator of the discussion panel on “Deficit or surplus? What to use these for?” The conclusions from the discussion within this panel pointed out the inhibitory effect of budget surplus on economic growth. Everybody shared the concern that budget surplus generates provokes strong desire in the Executive and in closely connected with it private economic structures for inefficient surplus spending.

Mr. Emil Kalchev, CED expert, was among the speakers within the discussion panel on the economic logic of the proposed changes in Budget 2006. He touched on the relations between monetary and fiscal policy – an aspect which is not widely discussed, and explained the logic of IMF’s economic policy which has determinative effect on Government’s fiscal policy. Mr. Kalchev pointed out that budgetary policy and in particular tax policy is not isolated from monetary economy and should be discussed in interconnection with latter. He underlined that,

outside the desire of the Executive for uncontrollable spending, the budget surplus policy has its monetary logic – it is an economically inefficient instrument for counteracting credit expansion. The inefficient monetary policy makes it necessary to use this economic instrument. The extremely liberal economists opposed to this opinion and defended the thesis that credit expansion, respectively the growing current account deficit, do not threaten monetary stability. Therefore they should in no circumstance be regulated.

## **Annual Meeting of Research Centers and the Policy Association for an Open Society – Brussels, 3-6 November 2005.**

The regular annual meeting of the Policy Association for an Open Society, which was established a year ago and includes 24 member policy centers (research institutes) from Central and Eastern Europe, the Baltic Region and Central Asia ([www.pasos.org](http://www.pasos.org)) was held in early November. This year, the Center for Economic Development as co-founder was represented by Mrs. Maria Prohaska, Director.

Discussions on the participation of the social policy institutions in the region and their experts in the decision making process of EU's governing bodies and on the perspectives for their more active involvement were organized during the meeting. The occasion was also taken to present to the European institutions the experience and capacity of the research centers in Central and Eastern Europe and in particular of association's member organizations.

The 2005 report, the 2006 working plan and budget, as well as other working documents on the preparation and implementation of joint projects were approved at the annual meeting of the association.

## **Working Meeting on the European Trend Chart on Innovations – November 2005, Rome**

The latest meeting of the team of experts working under the European Trend Chart on Innovations project took place in Rome on 24 and 25 November. Mrs. Anelia Damianova, Senior Expert, CED, took part in the meeting.

The results of a study of the innovation policy condition (European Innovation Scoreboard 2005) conducted by EC experts in cooperation with the national project referents were presented at the meeting. This is the fifth such study in a row reflecting the changes in the national innovation policies in the past year. The study covers the 25 EU Member States plus Bulgaria, Romania, Turkey, Iceland, Norway, Switzerland, the USA and Japan.

The study has been conducted employing indicators grouped in five categories – innovation drivers, knowledge creation, innovations and entrepreneurship, application of innovations in industry and protection of intellectual property rights.

The European countries are divided into five groups on the basis of their performance. The first group comprises the innovation leaders Sweden, Finland, Switzerland, Germany and Denmark.

The second group comprises countries with medium performance – these are the majority of the older EU Member States.

The third group comprises countries which are catching up or approaching the medium level – these are the majority of the new EU Member States.

The fourth group is that of the countries losing ground in innovation development, unfortunately including Bulgaria as well as Spain, Poland, Slovakia, Romania and Turkey.

The scoreboard shows that in innovations Europe still lags far behind the USA and Japan – the European countries allocate almost three times less funds for research and technologies compared to the USA. Besides, countries like China and India are rapidly growing into world research and development centers.

Taking account of these facts, at the end of 2005 the European Commission prepared an action plan to encourage European innovation. The ambitious tasks include increased government support, improved protection of intellectual property rights, additional funds for research, set up of innovation centers, improved business – university cooperation, improved conditions for private sector's investments in innovation, etc.

At the meeting the different countries presented in brief the basic measures to promote national innovation development.

The project will continue in the next two years with collecting and summarizing information on the research activity and innovation policy in the different countries. This will help to promote European innovation development in line with the Lisbon Strategy recommendations.

## Business Ethics Associations



The meeting in Haskovo at work, 30 November 2005.

Business Ethics Associations were established in Haskovo and Vidin on 30 November and 7 December 2005 respectively. Co-organizers of the events were the Center for Economic Development, the Municipal Association for Small and Medium-sized Business in Haskovo and the Regional Development Agency and Business Center – Vidin. The associations are established within the project “Involving Small and Medium-sized Business for Active Counteraction to Corruption” implemented by the Center for Economic Development in cooperation with the National Business Development Network and the National Association of Small and Medium-sized Business. The project is implemented with financial assistance from the EU within PHARE's Civil Society Development program<sup>49</sup>.



The meeting in Vidin at work, 7 December 2005.

Association members include owners and managers of companies, which have adopted their own Codes of Business Ethics. The members of these informal associations should exercise civil control on the administration, creating a new type of partnership relations with the latter based on mutual compliance with ethic rules. Active discussions on the problems of Bulgarian entrepreneurs took place during the constituent meetings. The business people shared particular cases of poorly functioning administration and unclear legal environment. Proposals to improve the conditions for doing business in Bulgaria were made as well.

<sup>49</sup> For more details on the project, see: [http://newwww.ced.bg/NEW\\_CED/corruption/Corruptions\\_files/](http://newwww.ced.bg/NEW_CED/corruption/Corruptions_files/) www.econ.bg



## Participation in Advocacy Training

Advocacy training was organized in Triada Hotel, Sofia, from 13 till 15 December 2005. It aimed at providing assistance to Bulgarian non-government organizations engaged in the judicial reform by expanding their knowledge of the advocacy process and building practical skills for successful implementation of advocacy initiatives.

The training was organized by the Bulgarian Center for Non-profit Law in cooperation with the US Agency for International Development (USAID), Bulgaria.

Trainers included Balasz Sator, Executive Director, Civil Society Development Foundation, Hungary, and Nilda Bulein, Executive Director, European Center for Non-profit Law, Hungary.

The training covered representatives of 30 non-government organizations engaged in the implementation of judicial reform projects with financing from USAID within the Bulgarian Legal System Strengthening Initiative.

Mrs. Aneta Slavcheva, Legal Advisor, CED, took part in the training on behalf of the Center for Economic Development.

## MEETINGS ON THE ROOF

### Meeting with US delegation within the Marshall Memorial Fellowship Program

A meeting with a group of US participants in the Marshall Memorial Fellowship program was organized in the hall “On the Roof” on 25 October 2005. The purpose is to acquaint the group of six persons (young political leaders aged between 28 and 40) who visited Sofia in October with the Bulgarian political, economic and social reality.

The Marshall Memorial Fellowship program was set up in 1982 by the German Marshall Fund – USA Foundation with the aim to present to the young generation of West-European leaders the USA, its institutions, policy and people. The program promotes the transatlantic relations, involving initially young political leaders and media representatives from Germany, Denmark, France and the Netherlands. Over time the program has been spreading across a larger number of countries to include now Bulgaria, the Czech Republic, Greece, Hungary, Italy, Poland, Portugal, Romania, Slovakia and Spain. Since 1999 German Marshall Fund introduces a US program component aimed at making the new generation of US leaders aware of European realities, transatlantic partnership and global challenges to the countries on both sides of the Atlantic.

The US participants in the program (21 people) start their tour from Brussels where they acquire knowledge of the European and transatlantic institutions; then they divide into small groups visiting different places in Central, Southern and Eastern Europe.

The young politicians on a visit to CED included Dr. Kean Beyzavi (Medtronic Vascular), Dr. Lisa Marrache (Maine, House of Representatives), Charles Poole (Counsel to the Governor, North Carolina), Teresa Rivero (Program Officer, Education of Gates Foundation), Robert Sahr (Public Utilities Commission, South Dakota), Kristi Sherrill (Director, G.W.Bush’s Presidential Inaugural Committee 2000-2001). They were accompanied by the Washington director of the Marshall Memorial Fellowship program Mr. Neil Sumilas and the national program coordinator for Bulgaria Mrs. Gergana Djenkova.

The guests were acquainted with the specifics of CED as an analytical economic policy center and with the priority areas in its work. A power point presentation on the Bulgarian Economy was made. Within this wide topic CED experts focused on the main challenges to Bulgaria and on the country’s strengths and weaknesses in achieving sustainable economic development and competitiveness. The guests asked many questions on the economic challenges in the preparation for accession to the EU, the independence of the judicial system and the fight against corruption and crime, the health reform and the education policy.

## NEW PUBLICATIONS



The new Annual Report on the Condition and Development of Bulgarian Small and Medium-sized Enterprises' 2004 was published in December in Bulgarian and in English. The report has been developed by a team of the Center for Economic Development in close cooperation with experts from the Ministry of Economy and Energy.

Following the amendments to the Act on Small and Medium-sized Enterprises (Act on SMEs) in August 2004, this report has been developed for the first time under assignment of the Ministry of Economy and Energy and has been financed from the state budget.

Small and medium-sized enterprises are discussed in the report in terms of the amended SME definition as formulated in the Act on SMEs. According to the new definition medium-sized are enterprises with 50 to 249 employed persons inclusive. Higher values are also attributed to the other criteria – annual turnover and fixed tangible assets. This further increases the importance of SMEs in the economic life.



The report provides a complete, comprehensive, concise and clear picture of the Bulgarian SME sector. The number of enterprises, business start up and market exit opportunities have been analyzed. A comprehensive characteristic of SMEs and their role in the economy has been made. The role of SMEs for creating employment has been discussed in detail. Attention has been focused also on the access of SMEs to finance and on the assessment of the business environment's impact on SMEs' behaviour.

An interesting section of the report is the outlined profile of the Bulgarian small and medium-sized entrepreneur, including an attempted presentation of women in the Bulgarian small and medium-sized business. A new point is the comment on the training of entrepreneurs with good professional qualities and skills by the Bulgarian training institutions.

A major question, to which the report provides an answer, is "Are Bulgarian SMEs competitive; what are the factors for improving their competitiveness?"

A novelty to the report is the special section on a topical subject for Bulgaria's economic development. This year the topic is Bulgaria Brand and the corresponding section of the report presents the rapid development of the Bulgarian tourist industry. Analysis of sector's strengths and weaknesses has been made; proposals for overcoming existing problems have been made with a view to make the sector sufficiently competitive on international markets.

One more novelty to the report is the interactive disk to the printed edition. It contains the SMEs Alphabet tool which provides brief descriptions of major indicators and characteristics of the Bulgarian business. The special Cube of Enterprises is also a new model applied for the first time in the study of SMEs.

The methodology of the report implies use of statistical information provided by NSI. The statistical information covers the period 2001-2003 with focus on 2003 (for more details about the methodology of statistical analysis, see below). The other information refers to the period since 2004. The statistical information has been completed with results from sociological surveys conducted in the past year by leading agencies, which reflect entrepreneurs' view and opinion about the condition and the problems of SMEs.